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# WHAT BORROWERS NEED TO KNOW ABOUT CREDIT SCORING MODELS AND CREDIT SCORES

## HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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# WHAT BORROWERS NEED TO KNOW ABOUT CREDIT SCORING MODELS AND CREDIT SCORES

**Tuesday, July 29, 2008**

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 2 p.m., in room 2128, Rayburn House Office Building, Hon. Melvin L. Watt [chairman of the subcommittee] presiding.

Members present: Representatives Watt, Cleaver, Green, Speier; Royce, and Barrett.

Chairman WATT. This hearing of the Oversight and Investigations Subcommittee of the Financial Services Committee will come to order. Without objection, all members' opening statements will be made a part of the record, and I will recognize those who wish to make an opening statement in order of seniority. I will now recognize myself for 5 minutes for an opening statement to kind of frame what we are here about.

I welcome all of you here. Credit reports and credit scores have become important instruments in evaluating whether to extend credit to borrowers. Surveys taken by the Consumer Federation of America indicate that most individuals do not understand credit scores even when they think they are knowledgeable about credit. Perhaps I am the best example of that. I probably know more about credit reports and credit scores today than I ever have before because, for the first time ever in my entire life, in preparation for this hearing, I actually got a copy of my credit report and my credit score; and even tried to get three of them, but I didn't have enough information to get into the machine to do all of that.

As the economy has slowed and credit is becoming harder to get, it has become even more important for consumers to understand credit reports, credit scores, and what it takes to improve them.

Today's hearing will focus on credit scores and credit scoring models, consumer access to credit scores, and proposals to use alternative data in assessing the creditworthiness of consumers. We are fortunate to have with us today representatives of all three of the nationwide credit reporting agencies, Experian, Equifax, and TransUnion, as well as a representative of Fair Isaac Corporation, which is widely credited with developing the first credit scoring model that became widely used in evaluating credit. These wit-

nesses are very knowledgeable and will help us to understand the process by which credit scores are calculated.

While we do not have a user of credit scores with us today, we do have a written statement from Capital One, one of the largest users of credit scores, explaining how they use both external and internally developed credit scores. Including this information in the hearing record will assist us in understanding how credit scores are developed and how they are evaluated by lenders when making credit decisions.

So I ask unanimous consent to insert the written statement of Capital One into today's hearing record at this point. Without objection, it is so ordered.

We will also explore at today's hearing the use of so-called "alternative credit data," such as rent and utility payments, in evaluating an individual's creditworthiness. This issue has a particular importance to individuals who have little or no credit history, commonly referred to as consumers with what are called "thin files." Some believe that increased reporting and consideration of this type of data could help to improve access to credit by consumers, especially those with thin files or those who have no payment histories currently being collected by the credit reporting agencies.

Others have raised concerns, however, about the collection and use of alternative credit data in evaluating an individual's creditworthiness. Concerns about accuracy, volume, and verifiability of this information have been raised by some people about alternative data.

We look forward to hearing more about this issue from our witnesses; and that is a segment of our hearing, which I hope those who raised it and wanted me to include it as part of the hearing will show up to talk about.

In addition to the written statement I have submitted for the record from Capital One, I also request unanimous consent to submit written statements from the Federal Trade Commission and Payment Reporting Builds Credit. We have requested a written statement from the Federal Reserve, and we will submit that for the record when we receive it, although it is not here today.

The Equal Credit Opportunity Act provides that a creditor may consider age in a credit scoring model as long as it is not assigned a negative value and is empirically derived and statistically sound in accordance with the Federal Reserve Board's regulations. And that is what we expect the Federal Reserve's written statement to explain, how they have been implementing this requirement.

The Federal Trade Commission, under the Fair and Accurate Credit Transactions Act, is charged with establishing the fair and reasonable fee that consumer reporting agencies may charge for disclosure of a consumer's credit score and their written statement, and the FCC's written statement explains how they have implemented this requirement. Payment Reporting Builds Credit, a consumer reporting agency that allows consumers to enroll and self-report on-time alternative credit information has also submitted a written statement describing their unique process. And without objection, I would submit for the record the FTC's statement and the statement of Payment Reporting Builds Credit. It is so ordered.

I thank all of our witnesses for being here today and look forward to an informative and useful hearing. And with that, I will recognize the gentleman from South Carolina, Mr. Barrett, who is substituting for our ranking member, who couldn't be with us today. You are recognized for 5 minutes.

Mr. BARRETT. Thank you, Mr. Chairman. I appreciate it.

Gentlemen, thank you for coming today.

Mr. Chairman, I want to thank you for holding this timely hearing on what borrowers need to know about credit scoring models and credit scores. Given the influence of credit scores on the financial lives of Americans, this hearing is appropriate and much needed.

Credit scores are not just numbers. The scores affect many parts of Americans' lives, including the terms and rates of their credit cards, what they pay on their mortgages, and even their job searches.

Unfortunately, credit scores are often misunderstood, and I hope this hearing will help clear up some misconceptions about these seemingly mystical numbers, which I believe allow credit to be extended more effectively and efficiently.

Before coming to Congress, I ran a small furniture store in the town of Westminster, Barrett's Furniture—Your First Choice for Quality and Value, gentlemen, by the way. We are not in business anymore, so no more deals.

Because I knew most of the people who came in my store—I knew where they worked, I knew their families, I knew their character—I was able to determine the credit risk readily available and often extended credit to those who might look a little risky on paper. Even if my customers might have to stretch a bit to make payments, they would make them; and because they would have to see me in the grocery store, walking around town, they felt obliged to do so in many cases. The system worked for me at Barrett's Furniture.

However, larger businesses or ones that are online need a way to determine the creditworthiness of a much bigger group of people, and credit scores provide a valuable tool to compare the credit risks of borrowers. Credit scores are simple, inexpensive, and effective predictors of risk that a business owner can use to make sound business decisions.

Generally, as policymakers, we want to create an environment where lenders can price risk as accurately and efficiently as possible, and the market will encourage and improve tools that help lenders make these risk calculations more accurate. Because of competition, lenders will choose to price risk as accurately and competitively as possible. Lenders want to ensure that their rates are competitive so they can attract borrowers.

At the same time, a lender who makes a practice of lending money that never gets repaid will probably not be in business too long. If credit scores are a valuable tool for predicting risk, they will apply them to lending decisions; but if credit scores don't accurately predict risk of late payments or default, they won't use them anymore. In short, the free market should help ensure the validity of credit scoring.

We have seen in the mortgage markets what can happen without proper lending discipline. While credit scores are only one tool that lenders can use to determine who gets a loan and the terms of a loan, I think it is a valuable tool in the way they are standardized, inexpensive, unbiased, and, most importantly, predictive of risk.

I would be very concerned about curtailing or banning the use of any impartial measure that helps companies better determine risk. I would also be concerned about any efforts that would make this number less predictive of risk. If we did any of these things, we would drive up the cost of credit for lower-risk borrowers, and we would essentially be subsidizing the risk for high-risk borrowers.

While availability of credit can be a benefit for those who can repay, we have seen in the housing market what happens when credit is widely available for those who cannot pay. Credit scores are not only a market-based method of allowing businesses to better estimate risk; they also reward sound financial decisions by borrowers. Credit scores are based on objective numbers and patterns of behaviors, and the very acts that lead to high credit scores basically constitute sound financial behavior.

Simply paying bills on time and not overextending oneself with debt tends to lead to better financial health; I think that is pretty much a given. At the same time, borrowers should know that credit scores are accurate measures of financial behavior; and I applaud Congress for passing the Fair Credit Act and the FACT Act so that consumers know their personal information is protected and that their credit reports contain accurate information.

Americans should also be familiar with what they should be doing for a good credit score, which should then also help improve financial behavior. I plan to hold a TeleTown Hall meeting for my constituents on financial literacy, because I believe this is an important skill for Americans. We should have the proper tools to make sound financial decisions, and I hope that this hearing will reinforce that, Mr. Chairman.

Once again, I would like to thank you for holding this hearing, Mr. Chairman, and I am confident that the findings will be very informative. I yield back.

Chairman WATT. I thank the gentleman for being here and for substituting for the ranking member.

Mr. Cleaver, do you wish to make an opening statement?

Mr. CLEAVER. Yes, Mr. Chairman.

Chairman WATT. You are recognized for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman, and Acting Ranking Member Barrett.

To the witnesses, we appreciate very much your presence and participation in this subcommittee hearing. I am very anxious to hear your testimony and to become involved dialogically with you, because I have some understandable concern about this issue.

The timing of this hearing, Mr. Chairman, I think is very, very appropriate, maybe fortuitously because of the current challenges facing the American public with the housing value dropping almost daily. And with almost all of the financial indicators suggesting that this may be one of the toughest financial periods that the people in our country have faced, at least this generation, credit becomes extremely important.

Recent news reports and congressional intervention have indicated that the impact of mortgage defaults has extremely damaged or decreased the availability of credit. Banks just a few years ago were making loans through the drive-out/drive-in window. You would just drive by and wave, and you got a loan.

And, of course, today it is very difficult, as you know, to get loans; the banks are closing their wallets. So the information that is gained for purposes of attaining credit and the vehicle by which credit is issued is of utmost importance right now.

A few years ago, I brought my grandmother, my maternal grandmother, from Waxahachie, Texas, to Wichita Falls, Texas. She was unable to care for herself, so we brought her up to give her a chance to spend her sunset years with two of her four grandchildren.

My grandmother eventually died, and as my sister and I began to put the pieces together, we discovered that not only did our grandmother not have a checking account, we could find no evidence that she had ever had one. We found no evidence that she ever had a savings account. She did have some money that she had sewn into a pillow. That was her savings. And you could see where she had restitched many, many times where she made deposits.

So I came to the conclusion—and she had an insurance policy, which needs to be discussed at another hearing, where she was paying 50 cents a week. And on the day she died—she had been paying it since I was a little boy; I remember when the insurance man used to come by with a little leather bag to collect his 50 cents every week, and when she died, she had $350 in life insurance. But that is another hearing.

The point I want to make is that my grandmother had no credit, but she paid all her bills. If she was out of town and her water bill became due, she would go back home to pay $3.50 for a water bill.

I am very interested in some of the uncommon ways that the En Bancs are functioning today. The Missouri Department of Insurance filed a report which suggested that the average credit scores were 12.8 percent lower in the inner cities of Kansas City and St. Louis in what is called the Boothill, the southern part of the State of Missouri—12.8 points lower. It also reported that certain ZIP codes could be looked at to see the low credit scores.

I am interested in discussing all of these issues with you, and I appreciate Chairman Watt calling this hearing. I look forward to your testimony.

Thank you, Mr. Chairman.

Chairman WATT. I thank the gentleman for his opening statement. And as usual, he brings a real-world perspective to these issues, so we need that.

The gentleman from California, Mr. Royce, is recognized for 5 minutes.

Mr. ROYCE. Mr. Chairman, thank you. I would just like to briefly welcome Mr. Stan Oliai here from Costa Mesa, which is in Orange County, California. He is the senior vice president of decision sciences for Experian Decision Analytics. Experian is here, along with Equifax and TransUnion; they are the three major credit reporting agencies that provide useful information to both consumers and to lenders in the United States.

I think the ability of lenders to properly assess the risk posed by potential borrowers through risk-based pricing is one of the most fundamental tools necessary for our financial services sector to function properly here in the country. Additionally, a consumer's ability to track their credit report through credit monitoring services allows them to understand what is impacting their credit score. It helps protect them against identity theft, and it limits the damage following security breaches.

So, again, I would like to welcome Stan Oliai here and all of our other witnesses testifying today. I yield back the balance of my time, Mr. Chairman.

Chairman WATT. I thank the gentleman for being here.

The gentlelady from California is recognized for 5 minutes.

Ms. SPEIER. Mr. Chairman, thank you for providing us the opportunity to have this hearing. I think the consumers of this country would be well-served to listen in on what we are going to be talking about this afternoon.

I want to welcome Mr. Quinn from Fair Isaac—which is located in northern California—a company that, over the years, I interacted with when I was in the State legislature.

I would just like to say in my opening comments that there is an incredible mystique associated with one's FICO score. And when I have reviewed this in the past, I am reminded of its being like a black box. We really don't know what goes into the Fair Isaac formula to come up with the FICO score, and in many respects it is guarded more rigorously than Fort Knox.

Having said that, I would just like to say to all of you who will be participating in this first panel, the biggest problem is with the errors in credit reports; and when there are errors in credit reports that are then transmitted to Fair Isaac and then incorporated into a FICO score, it is virtually impossible to undo it.

I was part of an exercise with a local TV station in Sacramento a couple of years ago where we took my credit information and looked at my FICO score and looked at the errors associated with my credit reports. And, Mr. Chairman, I would think it would be an interesting experiment if all the members who are on the committee this afternoon were given an opportunity to look at their FICO scores and then their credit reports to see how much misinformation there is in one's credit report. Because the credit report, from a historical perspective, has looked at 40 percent error rates associated with what is in the credit report. When that is then factored into a FICO score, you can see how many consumers across this country would be dismayed at a credit score that was not, in fact, reflective of their credit behavior.

I yield back my time.

Chairman WATT. I thank the gentlelady for being here. And we also were surprised at the interest in this hearing today. We welcome the presence of C–SPAN 3 that is covering this hearing. I think the topic has kind of taken on a life of its own in this credit environment, in this mortgage environment.

So we are anticipating an extremely interesting, informative, and educational hearing. It is not just for legislative purposes, but hopefully, people will look in and become more informed about

their own individual credit. And if they do that, I think we will have achieved a nonlegislative objective also.

I am going to proceed with introducing the witnesses. Their full biographies will be put into the record, so I am going to do a very, very abbreviated—with your permission—introduction of the witnesses.

Our first witness will be Mr. Thomas J. Quinn, who is the vice president at Fair Isaac Corporation, the corporation that I described briefly in my opening statement.

Our second witness has been informally introduced by his Member of Congress, Mr. Royce. He is Mr. Stan Oliai—I think I got it right—senior vice president, Experian Decision Analytics, Experian PLC.

Our third witness on this panel will be Mr. Richard G. Goerss, chief privacy officer and regulatory counsel at Equifax, Inc.

And our final witness on the first panel will be Mr. Chet Wiermanski, group vice president, global analytical and decision systems, TransUnion LLC.

Without objection, each of your written statements will be made a part of the record in their entirety, and each of you will be recognized for 5 minutes or thereabouts to summarize your testimony.

You have a lighting system in front of you. It starts off green, goes to yellow at 4 minutes and to red at 5 minutes. We don't expect you to stop in the middle of a sentence; just sum up as quickly as you can. I have not been accused of being all that tough on the gavel in opening statements because we are here to learn what you have to tell us. But your full statements will be made a part of the record, and so we hope that you will summarize within approximately 5 minutes.

Mr. Quinn, you are recognized for 5 minutes.

## STATEMENT OF THOMAS J. QUINN, VICE PRESIDENT, FAIR ISAAC CORPORATION

Mr. QUINN. Mr. Chairman, and members of the subcommittee, my name is Tom Quinn, and I am vice president of global scoring solutions for Fair Isaac Corporation. Thank you for the opportunity to testify before you today regarding consumer education issues involving credit scores.

Founded in 1956, Fair Isaac Corporation is the leading provider of analytics and decision-making technology. We are not a credit reporting agency, but partner with the national credit reporting agencies to implement and distribute the FICO scores we develop to the thousands of U.S. lenders who use this score in their decision process.

A FICO store is a three-digit number ranging from 300 to 850, where the higher the score, the lower the risk. Lenders use the score, along with other information, to decision the request for credit and set the credit line and pricing terms.

Creating the FICO score model requires two samples of credit reports, 2 years apart, for the same randomly selected depersonalized set of consumers provided by one of the national credit reporting agencies. Those credit factors found to be most powerful and consistent in predicting credit performance individually and in com-

bination form the basis for the complex mathematical algorithm which becomes the score.

The traditional FICO score model evaluates five broad types of data elements from the consumer credit report. These include, listed in order of importance: Previous credit payment history, about 35 percent contribution; level of outstanding debts, about 30 percent contribution; length of credit history, 15 percent contribution; pursuit of new credit, 10 percent contribution; and mix of type of credit, about 10 percent contribution.

FICO scores were first introduced to the marketplace in 1989 and have been consistently redeveloped and updated throughout the years to ensure their predictive strength. Since it was first introduced, authorized user credit account information present on the credit report has been considered in the FICO score calculation.

Last year, Fair Isaac announced that with our new model update, which is referenced as FICO '08, authorized user accounts would no longer be included in the calculation of the scores. Fair Isaac was trying to protect lenders and consumers from a new type of credit repair practice known as "piggybacking." Piggybacking is an attempt to artificially and deliberately misrepresent consumers' credit histories to potential lenders by paying consumers with good credit scores to add strangers with poor credit scores to their credit card account as an authorized user.

After consulting with the Federal Reserve Board and the Federal Trade Commission earlier this year, we have now decided to continue considering authorized user account tradeline information in the FICO '08 models. Our scientists have devised a method to consider these trades while materially reducing the negative impact that could arise from the piggybacking practice.

Fair Isaac also pioneered the use of alternative data to assist in credit decisions for the 30 to 50 million consumers with thin credit files or no credit files. Our FICO expansion score service evaluates nontraditional credit history information provided by specialized credit bureaus, including payment performance records for purchases such as furniture bought on layaway, verified bill payment information, membership account performance at retail lenders, and selected performance involving bank deposit accounts such as the propensity to overdraw checking accounts.

Fair Isaac has been a pioneer in consumer education about credit scores. On March 19, 2001, Fair Isaac, in partnership with Equifax, launched its score explanation Web site for consumers called myFICO.com. At myFICO.com the consumer obtains their FICO score, the underlying credit report on which it was generated, as well as a detailed explanation of the score and the reasons why their score was not higher.

The price of the product was $12.95 in 2001, when first introduced, and has increased over 7 years to, currently, $15.95, for an average annual rate of increase of 3.3 percent. During the past 7 years, Fair Isaac has introduced additional products to help consumers with their credit management objectives.

To date, approximately 20 million FICO scores have been delivered to consumers from myFICO.com and Equifax.com via affiliates. By using myFICO, consumers have taken the step to control

their credit lives and help improve and protect their overall financial health.

There also is an abundant amount of educational materials about credit scoring on myFICO.com; myFICO has also partnered with consumer outreach entities such as the Consumer Federation of America on creation of credit score educational materials which have been distributed to thousands and thousands of consumers nationwide by both organizations.

Fair Isaac is regulated at the Federal level by the Federal Trade Commission. We have a regular, ongoing dialogue with the FTC in which we explain our products and practices. In addition, we frequently interact with and conduct education programs on FICO scores for the FTC, the OCC, the OTS, the FHA, the FDIC, and the Federal Reserve. We also regularly speak with many State attorneys general and other government officials.

I thank you for the opportunity to share with you Fair Isaac's expertise and experience in this important area.

[The prepared statement of Mr. Quinn can be found on page 136 of the appendix.]

Chairman WATT. Thank you so much for your testimony.

Mr. Oliai.

**STATEMENT OF STAN OLIAI, SENIOR VICE PRESIDENT, EXPERIAN DECISION ANALYTICS, EXPERIAN PLC**

Mr. OLIAI. Good afternoon, Chairman Watt, Representative Barrett, and members of the subcommittee.

My name is Stan Oliai, and I am senior vice president for Experian Decision Analytics. I would like to thank the committee for the opportunity to testify here today and provide the information that will describe how credit scores are developed and used. I will summarize the longer statement that I have submitted for the record.

In starting, I would like to go over a brief background of Experian. With our North American headquarters in Costa Mesa, California, Experian currently operates in 65 countries with more than 15,000 employees worldwide. Experian is well known in the United States as one of the three national credit reporting agencies; however, Experian is also a global leader in providing information, analytical tools, and marketing services to organizations and consumers to help manage the risk and reward of commercial and financial services. My business unit, Decision Analytics, serves as one of the world's largest providers of software for credit scoring, fraud detection, and risk-based pricing.

Most lenders use a credit score to estimate the relative risk that a consumer presents in repayment of a loan, and use the score as part of a process to price the product accordingly. The use of scores for risk-based pricing has led to significant increases in efficiencies in the market that provides tremendous benefit to both businesses and consumers. Some of the tangible consumer benefits include less cross-subsidization of risk, lower prices, more available capital, and real-time lending decisions.

Despite these benefits, the process is often not fully understood or appreciated. One thing that is sometimes misunderstood is the role of the credit reporting agency in the lending process.

I want to emphasize that neither the company that developed scores nor the credit reporting agency that delivered the information to scoring models participate in the actual lending decisions. We simply are not in a position to testify as to how scores are weighted or what other information, besides the scores, is considered when a lending decision is made. The lender is the entity that makes those decisions.

Credit reporting agencies do, however, provide credit reports and can generate a credit score from a model chosen by a lender. These credit scores are then used in the lenders' own proprietary underwriting process which would likely use information from multiple internal and external sources when making such a decision.

It is worth noting that each lender is different. An acceptable risk level for one lender may not represent an acceptable risk level for another. For example, one lender may see one recent 60-day late payment as acceptable while another may not.

I would like to briefly describe what a credit score is and how it is calculated.

A credit score is a numerical expression of risk of default based on a credit report. The score is produced by a mathematical formula created from a statistical analysis of a large representative sample of credit reports. The formula is typically called a "model."

The credit score is calculated by the model, using only information in the credit report. These reports include the following types of information: The credit account history, such as was the account paid, was it paid on time, how long has the account been open, and what is the outstanding balance; the type of account, is it a mortgage, is it an installment, is it revolving; the public record information, liens, judgments, bankruptcies, for example; and inquiries in the credit file that represent applications for new credit and other consumer-initiated transactions.

A credit report does not include information such as income or assets. It also does not include demographic information such as race or ethnicity. Demographic factors are not used in the calculation of a credit score.

Regulation B allows lenders to use models that are empirically derived and demonstrably and statistically sound.

Regulatory oversight of credit scores is accomplished through routine bank examinations for compliance with a number of laws that govern fair lending, such as the Equal Credit Opportunity Act. This makes sense because the lender chooses the scoring model to assist in this proprietary underwriting process. The lender is ultimately responsible for demonstrating to regulators that the scoring model it has chosen complies with the lending laws.

Next, I would like to describe how consumers can obtain their credit scores, as well as maintain a good credit score.

A consumer can obtain a free disclosure of the credit report once a year from www.annualcreditreport.com. While obtaining an Experian credit report through that Web site or at any time through Experian.com, a consumer can obtain their VantageScore for $5.95. Since Experian believes it is in the consumer's best interest to acquire the credit report and the score at the same time, we also offer a combined package of both for $15. This way, consumers

are able to see how the score and the accompanying reason codes actually relate to the information in the credit report itself.

The committee has asked about the total number of scores and consumer disclosures Experian has made to consumers since the FACT Act was enacted. We are pleased to provide an aggregate of those numbers to the committee through our trade association, the Consumer Data Industry Association, or CDIA, that is compiling this information across the industry, and will provide it to the committee as soon as possible.

I would also like to describe the benefits of credit scoring. Credit scores provide a marked improvement over manual review. Their use allows for lending decisions to be made accurately, efficiently, and in a timeframe convenient for consumers. Since a credit score is calculated on the information in the credit file, the potential subjectivity on the part of a lender is limited. Credit scores form consistency in decisions as the same formula is applied evenly across a lender's portfolio. In fact, automated credit scoring leaves much less opportunity for discrimination in a potentially subjective assessment by a lender.

Credit scores are blind to the factors protected by the Equal Credit Opportunity Act, which include race, color, religion, national origin, sex, marital status, and age.

In conclusion, credit scores remain one of the great advancements in consumer lending and represent enormous opportunity for both consumers and lenders. Experian works hard to ensure that we have accurate and up-to-date credit information. We do this so that consumers are assured that their credit scores will serve as a useful tool in helping them to obtain the credit for which they are eligible.

Thank you for the opportunity to express Experian's views on this important issue.

[The prepared statement of Mr. Oliai can be found on page 126 of the appendix.]

Chairman WATT. Thank you for your testimony.

Mr. Goerss of Equifax, you are recognized for 5 minutes.

**STATEMENT OF RICHARD G. GOERSS, CHIEF PRIVACY OFFICER AND REGULATORY COUNSEL, EQUIFAX, INC.**

Mr. GOERSS. Mr. Chairman, and members of the subcommittee, I am Richard Goerss, chief privacy officer and regulatory counsel for Equifax Inc. We have filed written testimony for the record, and with your permission, I would like to take just a few moments to highlight that testimony.

I want to thank you for this opportunity to testify regarding what borrowers need to know about credit scoring models and credit scoring. My oral testimony is primarily focused on the information that Equifax provides to consumers about credit scores, and how consumers can obtain credit scores from Equifax.

Founded in 1899, Equifax Inc. is the oldest, the largest, and the only U.S. publicly traded of the national companies that provide consumer information for credit and other risk assessment decisions. As one of the three national credit reporting agencies, the activities of Equifax are highly regulated under the Fair Credit Reporting Act and other related Federal and State statutes. Equifax

is a highly responsible steward of sensitive consumer information, and as such, we are committed to fairness and privacy protection for consumers.

My written testimony describes what a credit score is, discusses the benefits which credit scoring provides to both consumers and lenders, discusses Equifax's scoring models and scores, explains how consumers can obtain their credit score directly from Equifax, and identifies some steps that consumers can take to improve their creditworthiness and, by extension, their credit scores.

Even more of that information is available on the Equifax Web site. For $7.95, consumers can obtain a disclosure of the Equifax FICO, or Beacon score, which is the credit scoring model most commonly distributed by Equifax to lenders.

Consumers can request a credit score disclosure by itself, that is, without a copy of their credit file, a credit monitoring product, or any other ongoing scoring products, by sending a written request with proof of identity to Equifax, Post Office Box 105252, Atlanta, Georgia 30374, or by calling us toll free at 1–877–SCORE–11 or 1–800–685–1111.

Consumers calling these toll free numbers also have the option to order their credit score disclosure together with a copy of their Equifax credit file, and if they choose to, just order a copy of their Equifax credit file without, in fact, the score disclosure.

In addition to the consumer's score, the Equifax score disclosure package includes the key scoring factors that affected the consumer's credit score, the FTC's summary of consumer rights under the Fair Credit Reporting Act and other information.

Additionally, consumers who obtain their free FACT Act annual file disclosure from Equifax through the annualcreditreport.com Web site can also obtain credit score disclosure along with their free annual credit file disclosure, if they wish to do so.

Further, consumers entitled to free credit file disclosures for other reasons under the Fair Credit Reporting Act or State law can request free disclosure, free file disclosure at www.Equifax.com/FCRA where these consumers are also offered the opportunity to obtain their credit score disclosure. Additionally, at our Web site, www.Equifax.com, consumers can obtain, at no cost, general but helpful information about credit scores.

Let me close by saying a word about the critical and positive role played by credit scores.

These scores promote fairness in consumer lending decisions, help to make credit available to a broad range of consumers, and help to increase efficiency and cost effectiveness in our consumer credit markets. Increasingly, the emphasis on credit scores is helping consumers to better understand their underlying credit reports and the financial literacy elements of consumer credit.

At Equifax, we are proud of the early and pivotal role we have played in developing credit scores and working with lenders and consumers to meet their lending and borrowing needs, but more needs to be done in this very dynamic marketplace. Equifax, for example, is continuing to look at alternative data and other sources and means for credit scores and for credit decisions.

Thank you again for the opportunity to testify on this important issue. Equifax looks forward to continuing to work with the Con-

gress on scoring issues and on educating consumers as to what they need to know as borrowers about credit scoring models and credit scores. Thank you.

[The prepared statement of Mr. Goerss can be found on page 82 of the appendix.]

Chairman WATT. Thank you for your testimony.

Mr. Wiermanski, you are recognized for 5 minutes.

**STATEMENT OF CHET WIERMANSKI, GROUP VICE PRESIDENT, GLOBAL ANALYTICAL AND DECISION SYSTEMS, TRANSUNION LLC**

Mr. WIERMANSKI. Chairman Watt, Congressman Barrett, and committee members, thank you for your invitation to TransUnion to testify today on the important subject of what borrowers need to know about credit scoring models and credit scores.

At TransUnion we are proud of our contribution to the continuing development of credit scoring models which have fostered the availability of financial services to American consumers. TransUnion provides our customers in the financial services industry with scoring models which help financial institutions increase the breadth of their services to consumers. We provide individual consumers with educational information about credit scores, and we have for many years encouraged full-file reporting by utilities and telecommunication firms as, if practiced, benefits in particular those consumers with thin credit files.

Mr. Chairman, without any doubt, the use of credit scoring has produced significant consumer benefits. The growth of consumer credit scoring has allowed lenders to more accurately predict risk exposure at multiple levels. This has allowed the implementation of more granular, risk-based pricing strategies which, in turn, has led to decreased cost and increased availability of consumer credit. The same phenomenon has occurred in the property and casualty insurance marketplace.

It is important to explain what a credit score is. A credit score is simply a numeric reflection of a consumer's predicted behavior, such as creditworthiness, based upon an evaluation of several different factors. Prior to credit scoring, lenders relied on individual loan officers to eyeball a credit application and determine whether the consumer was a good credit risk. Credit scoring standardizes that process within a lender's company and allows for a more objective and uniform review of applications.

It is important to note that there is not one credit score for a consumer. Credit scoring models vary among lenders, consumer reporting agencies, and credit score providers. Credit scoring models can vary within the same lender, such as if a lender uses one scoring model for approving credit card applicants, but a different model for mortgage underwriting.

We believe that a credit score such as the TransRisk or VantageScore a consumer can buy from TransUnion is very useful in giving the consumer a general understanding of how a lender may evaluate the consumer's creditworthiness. Although these credit scores are used by lenders and insurers, they also allow consumers to have a general understanding of credit scores.

I should also note that a consumer need not even buy a credit score to understand the key factors considered in most credit scores. This type of information is available from us at no cost. Although understanding the credit scoring process has clear consumer benefits, in our experience it is more important for the consumer to verify the accuracy of the information in his or her credit file at a consumer reporting agency.

At TransUnion, we believe that a consumer's first priority on this issue should be to exercise the right to obtain a free annual disclosure of his or her credit report and to ensure that the information is complete and accurate.

There are hundreds of credit scoring models used by creditors and insurers, but there are presently just three nationwide consumer reporting agencies which maintain a central Web site, annualcreditreport.com, from which each American can obtain a free annual credit report from either TransUnion, Equifax, or Experian.

Credit scoring models depend on the accuracy, completeness, and integrity of the underlying information in the credit report; as such, that deserves priority.

Finally, I want to touch briefly on the issue of alternative data. There is strong evidence to suggest that consumers would benefit from the increased reporting of nontraditional credit information. For example, consumers with thin credit files and, in particular, minorities, immigrants, young and old, all experience a net benefit from full-file reporting by energy companies and telecommunication providers. Consumers with impaired credit histories also obtain a net benefit from full-file reporting by these companies.

We are presently engaged in a follow-up study to learn more about the impediments to full-file reporting faced by the utilities and telecommunication industry. It may be very well that Congress may have a role to play in removing roadblocks to encourage voluntary full-file reporting.

Thank you again, Chairman Watt and Ranking Member Barrett, for this opportunity to present our views. I look forward to answering any questions you may have.

[The prepared statement of Mr. Wiermanski can be found on page 173 of the appendix.]

Chairman WATT. Thank you so much.

I would like to thank all of these witnesses for being with us.

We will now recognize each member of the subcommittee for 5 minutes each to ask questions of this panel. And, as usual, I have a whole file full of questions. That is what happens when you learn more and more about what is going on in a particular area.

I would say as a general statement, just to set you at ease, that I have become more and more convinced of the value of having some form of credit reporting and credit scoring. There are a couple of concerns about things, though.

Number one, I noticed when I got my credit report that because I had gone into a department store, for example, where they told me, okay, if you open our department store credit card we will give you a 10 percent discount on your purchase. It sounded like a no-brainer to me—I mean, 10 percent off the top. But I didn't realize until today, when I started reviewing my credit report, that by

doing that, I was actually worsening my credit. On each of those three occasions where I did that, I got the 10 percent or 15 percent discount; on at least two of the three occasions, I have never used the credit card again.

So the first question I have is, you mentioned that debt is obviously one of the factors that you consider in your modeling. But in that case, debt was not the amount that they required me to charge on that first transaction, but the $5,000 credit limit that they gave me that I never went back or used.

So I am concerned that either we ought to be making retailers disclose that opening those accounts could have an adverse impact on credit or that the definition of debt when you are doing your modeling perhaps should take into account only what somebody has incurred as opposed to some limit that they quite often never use.

In fact, I don't think on any of the credit cards that I had reported on, I have ever gotten anywhere close to the maximum credit that they have authorized me, yet it seemed to me that you were taking into account the maximum credit that really never got used. How can this be addressed?

Now, the second question I have is—and I am going to let you answer both of these together because I know I am going to run out of time; and this is happening with a bunch of students now, apparently. They are shopping around for the lowest rate that they can get on a student loan.

I noticed on my credit report, when I went shopping for alternative credit to find the best available credit, the inquiries count against my credit rating. That seems to indicate to me I am a better shopper, I am a better consumer or to be a positive that I am shopping around, rather than a negative that I am shopping around; yet, it seems to me in the models that are being used, that becomes a negative factor in evaluating my credit.

In fact, all three of your companies will be getting a letter from a number of us about these student loan issues soon. So if you are not prepared to answer that one today, we are going to try to get you to answer it at a later date.

But give me your responses on both of those two issues that I have raised.

Mr. Oliai, do you want to go first?

Mr. OLIAI. I would like to.

On the first question regarding applying for a retail card at point of sale to get a discount, that is actually a very common practice and, frankly, like you say, a no-brainer by and large. While it does post an inquiry to your account, which generally the more inquiries you have, the higher—the relationship is towards a higher level of risk, that occurs when there is a good amount of new inquiries. One, two, or three generally don't move the dial that much. And I am using some general terms.

If I were to take your example even that much further, there are multiple ingredients in a credit score. And so, while having the additional retail inquiries may have taken a few points off of it, opening up a new account for which you have so much available credit, the difference between what you actually used versus the line that was assigned actually works in your favor. This shows the more

available credit you have, the better your credit standing in general.

So we can't look at these kind of on a one-attribute-by-one-attribute basis, as it is a combination of factors that come into and feed the score.

It would be interesting to look at your case in particular. My gut feeling tells me your score probably would have increased over time because of that tradeoff between the one inquiry and the increased amount of available credit.

Chairman WATT. I confess I did have a pretty good credit score, but it wasn't 850. I understand that there is a zero probability that somebody can get an 850 score. That is another thing I learned in this process.

Mr. Goerss.

Mr. GOERSS. Well, I am not the—the gentlemen here are the statisticians and model developers. But for the Equifax models, the combination of inquiries, our models that we develop don't take inquiries into much account at all. So that addresses either—

Chairman WATT. Into much account or into no account?

Mr. GOERSS. Four of our models take them into no account, one or two of our models use it to less than 1 percent. So most of our models—

Chairman WATT. So in your model, students who are shopping around for student loans, making inquiries, that is not going to count against them?

Mr. GOERSS. That is correct, it would not. Nor—

Chairman WATT. What about you, Mr. Wiermanski?

I am going to get it right at some point. That is what you get for accusing me of being Polish. I am just going to butcher your name the rest of the day.

Mr. WIERMANSKI. Just to add to what Stan had mentioned, inquiries are included in the model because they prove statistically that they do rank-order the risk. So that is why any components in a credit scoring system find their way into the score. The amount—

Chairman WATT. Say that one more time.

Mr. WIERMANSKI. The inquiries find their way into a credit scoring system based upon empirical and statistically valid data, and that is how they find their way into being included as a component of a credit scoring model.

The weights that are assigned—

Chairman WATT. So you are saying, by and large, the more inquiries you have, generally the worse your credit is going to be. But for somebody where that is not the case, it ends up working against them because on a general level, statistical level, it is predicted.

Mr. WIERMANSKI. And as Stan had mentioned, as the number of inquiries increase over a period of time, they become more severe in terms of how you might be penalized on your credit score.

I do want to note that in one of our models, developed specifically for consumers with past credit delinquencies, the presence of the first inquiry actually is treated positively. So consumers who may have had delinquent information posted to their credit file, when they go shopping after a period of time and if that is one inquiry, they actually are rewarded for shopping responsibly. If there are a

number of inquiries quickly afterwards, then they do become penalized. So inquiries, by nature, are not always treated negatively.

And then the last piece on student shopping, there is a practice in the industry, which varies across scoring systems, which is called "inquiry de-duping," where inquiries within a period of time from the same type of institution—and this is particularly implemented for auto loans and mortgages; they group the inquiries from banks, finance companies and mortgage companies and treat them as one. And at TransUnion we have looked at this student shopping phenomenon; and the way that our de-duping process works, we believe that consumers would not be adversely impacted by shopping for student loans because the way we go about de-duping the inquiries, reduced—minimizes that shopping behavior.

Chairman WATT. Okay. My time has expired. We will do follow-up on the student side of this in particular because I think, more and more, people are raising this as a concern. And it may not be a real concern based on what you have testified, but I think we need to get that verified.

Mr. Barrett is recognized for 5 minutes for questions.

Mr. BARRETT. Thank you, Mr. Chairman.

Mr. Goerss, you mentioned alternative sources rather than, I guess, your standardized. And there are a lot of different things. Talk to me a little bit about alternative sources and what other issues or what other scoring methods we can use.

Mr. GOERSS. There are a number of different alternative sources. I think probably a definition of alternative data would be data that is not currently used in the credit file. We, at Equifax, have experience working with utility companies, have developed and managed utility exchanges. They contain a limited amount of telco and utility information accounts that are used by the members of that exchange in limited roles at this point, but they are used to help the members determine if a credit deposit needs to be assessed or not.

And so we are working with them and will continue to work in that area. We are also looking at different sources for rental-type accounts, such as landlord-tenant, are there other rental-type accounts that can be used.

For all of the information that can be used, that is alternative data, it is important to analyze what it brings to a credit-reporting decision. Are the data furnishers or would the data furnishers be in a position to meet all of the FCRA requirements for data furnishers, in terms of making sure the information is accurate, making sure that they participate in the reinvestigation process as needed? But we feel that there are certainly a lot of opportunities in that area that we continue to pursue.

Mr. BARRETT. Okay. Let me move along a little bit.

Now, Mr. Oliai, you talked about an automatic credit system. I guess when I thought about somebody's credit score, I thought about a person coming in and somebody taking a look and saying, "That is Gresham Barrett," yada, yada, yada.

Do you plug all this stuff into a machine and the machine just factors all of this data? Tell me a little bit about an automatic credit score.

Mr. OLIAI. Sure. First of all, there are so many different types of credit scores. But, typically, they are implemented electronically,

so that when a lender or credit granter of any kind pulls a credit report, the score is returned straight away, either calculated and returned by one of the bureaus or calculated in their own environment with their own application processing and decisioning software.

So that score is, just as we mentioned before, one element of the overall credit decision that is then plugged into some sort of decision framework, that proprietary decision framework that a lender or credit granter would have. So it is done very much on the fly, real-time, with respect to credit applications.

Mr. BARRETT. Okay. Mr. Wiermanski, I know when I was in the furniture business, when we pulled somebody's credit report, there was hardly anybody who didn't have some type of medical bill in some shape, form or fashion. Tell me how that affects credit scores, some type of medical bill, because we had people who had excellent credit with the exception of medical bills, and they always paid their bills. So, kind of factor that into it.

I am a big proponent of the free market. I think everybody needs to use their own formula. But would there be an advantage—two questions: about medical bills; and the possibility of some standardized form that everybody used, just one, rather than several different ones. If you would take those two.

Mr. WIERMANSKI. The way that medical bills would find their way into a credit bureau typically would be from a bad debt collection opportunity. So my understanding is that most of the generic models that are offered, whether they are developed by TransUnion and other third parties, typically do include those medical items when they surpass a certain threshold. And, at this point, I don't know what that threshold is; I believe it might be $100.

At TransUnion, we have just introduced our new versions of our TransRisk scores, the 3.0 versions. They do not take medical collection items into consideration in the score calculation. So we have engineered those where we cannot include them for credit scoring.

So I think in terms of how we might be able to standardize our approach, it would be worthwhile to have the debt collection agencies have some type of standardized nomenclature returned to the bureaus to identify medical debt so that they can be considered in the scoring systems, or not.

Mr. BARRETT. Okay. Thank you.

Mr. Quinn, say I am a high school student getting ready to go to college. How do I build my credit history, number one? And, number two, we as leaders, how do we do a better job of educating individuals on financial situations, how to keep their rear end out of debt? That is a South Carolina term; sorry about that.

Mr. QUINN. I think we can all understand that term.

I think one of the best ways to help young adults establish credit is through the family interaction, parents educating the young adults about how to manage their credit in their day-to-day examples in household debt management.

And there is a variety of different institutions out there that have programs set up to help young people establish credit. Sometimes it requires a cosigning, for example, with a parent. Credit card issuers do have the authorized user approach as one way to help younger consumers get established with credit.

So I think there is a variety of different options out there to help young people get established with credit. I think, again, the challenge is, are they aware of that, and if they are not, how can we collectively make them more aware of those opportunities?

Mr. BARRETT. Thank you, gentlemen.

My time is up, Mr. Chairman.

Chairman WATT. I thank the gentleman.

Mr. Cleaver is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

I was sufficiently depressed listening to you talking about what you learned about your credit score and the inquiries. I have a lot of questions, so I am hoping you can give some succinct responses.

Let us say I have a credit card, the "Sink You" credit card, and I have a $20,000 limit, and someone inquires about my credit, and my highest monthly balance has been $10,000. But, as the reporting comes in, the software suggests that my highest balance is also my credit limit, so that the $10,000 represents an exhaustion of my credit, that I have gone to the top.

Does that negatively impact my credit score?

Mr. QUINN. No. With FICO scores, the way we look at credit card information in calculating the scores is we first look at the limit field to see if there is information that has been supplied by the credit card issuer in terms of the line, so the $20,000 in your example, if that is available, that is the figure that we would use in trying to calculate a revolving utilization calculation, for example.

If it is missing, then we default to the highest balance field and use that as the limit in default, if it is not provided in the limit field, because the data in our analysis shows that is predictive.

If that information is missing, then we bypass that credit card in any of our utilization calculation characteristics in the score.

Mr. CLEAVER. Thank you.

I am probably more interested in the three rating agencies.

Mr. OLIAI. I will take the first crack.

With the VantageScore, we actually do not include the trades without a limit reported.

Mr. CLEAVER. Say that again, please.

Mr. OLIAI. In VantageScore—let me take a step back. Typically where credit limit becomes an issue, or the reporting of credit limits becomes an issue, is when you are calculating utilization or the relation between the balance on the card over the limit. So—

Mr. CLEAVER. And when you do this, this is not taking into any account the credit limit?

Mr. OLIAI. Well, more often than not, the limit is reported to us. And so we are getting the actual limit from the card issuer. There are some models, and you just heard Mr. Quinn talk about one in which there is some logic built in that will go to high balance if limit is not available.

As an alternative, with VantageScore, we do not let that particular trade line come into the utilization calculation where we have no limit. So it wouldn't adversely impact a consumer because an issuer hasn't reported the limit information.

Mr. CLEAVER. But if a person appears on the credit report to utilize his or her credit limit, that impacts negatively; is that right?

Mr. OLIAI. Well, in general, the more available credit that you have that is used up and therefore not that much available credit left, that will point in the direction of a higher level of risk on its own.

As I mentioned before, there are multiple ingredients in a credit score.

Mr. CLEAVER. Okay. In your opening statement, which I appreciated, you essentially said that the credit rating agencies, and let me use a Biblical term—there is no respect of persons, right?

Mr. OLIAI. I am sorry?

Mr. CLEAVER. "No respect," it is a biblical term, means that nobody gets preferential ratings, that everything is equal, that you mentioned there is no consideration given to race or gender. In the Bible—I don't want to do a Bible study, but the quote is, "For there is no respect of persons with God." Anyway, and now turn, please, to the New Testament.

[Laughter]

But I have a report here which would suggest the opposite from the Missouri Department of Insurance, which I made reference to earlier. It suggests that regions and ZIP codes suggest credit ratings.

Mr. OLIAI. One is not necessarily tied to the other. The data that we use in the credit scores is what is available on the credit report, and we are completely blind to issues of any kind of ZIP preference or redlining or race or ethnicity.

The fact that there are correlations doesn't necessarily imply cause and effect. So we have done extensive studies, as I am sure other groups have done, that show that these models work very well irrespective of what geography or segment of the population you are looking at.

Mr. CLEAVER. Well, I don't think it is racial. I mean, the Bootheel of Missouri is essentially all white, and the report suggests that their credit scores are lower than the wealthier regions. But it also suggests that if you go to the ZIP codes, the minority communities then pop up as having lower ratings.

When you are giving out information—this is a question—when you are giving out information, you do not use any information other than the actual score? I mean, you are not extracting any information that would give the lender any clue or indication about the geography of the person seeking that credit?

Mr. OLIAI. That is correct; the geography will not play into a credit score.

I would add, though, that if you were to take it and dissect it a little bit further, you might look at certain geographies and see a higher incidence of delinquency or default that has nothing to do with the geography in general, just that you have like-minded consumers living closer together. And that is probably more what is driving the score result than anything else.

Mr. CLEAVER. Okay. One final question, Mr. Chairman, please, sir?

Chairman WATT. Go ahead. It looks like we are going to have to give people an opportunity to come back. So if the gentleman doesn't mind holding his question, we will do another round, be-

cause I have about 15 more questions that the staff has given me since I used up my 5 minutes.

Mr. CLEAVER. Well, thank you, Mr. Chairman. I yield back the balance of my time.

Chairman WATT. Okay. Which you didn't have.

[Laughter]

Mr. Green is recognized for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

And I thank the Reverend for introducing, I believe it was the New Testament where you left off. So I will move us from the New Testament to the Now Testament, if I may, and the Book of Credit.

Mr. Quinn, my suspicion is that you may be picked on more than your colleagues simply because of the difficulty of pronouncing their names. So if it seems as though I am leaning toward you, it may have something to do with this difficulty.

But let's start with the comment that was made about on-the-fly, real-time, automated results. I believe that this is a question that would go to Mr. Oliai.

And am I pronouncing your name correctly, sir?

Mr. OLIAI. "Oliai."

Mr. GREEN. "Oliai," all right. Mr. Oliai, you said real-time results; what does that mean in terms of actual time? Is it seconds, minutes? What is it, please?

Mr. OLIAI. It is typically subsecond.

Mr. GREEN. Subsecond?

Mr. OLIAI. Yes.

Mr. GREEN. Meaning you can make the inquiry, press some key, and within as much time as it takes to print, you have the results?

Mr. OLIAI. That is a fair statement. Probably an easy example of that is Chairman Watt's experience getting the 10 percent discount on a card. That a real-time decision, and the discount was offered right there on the spot.

Mr. GREEN. And I would assume that this is then full-file traditional credit?

Mr. OLIAI. This would apply to any applicant.

Mr. GREEN. Any applicant? All right, well, let's talk about an applicant who does not have traditional credit but may have what we will call alternative credit—light bill, gas bill, water bill, phone bill, and maybe some other nontraditional things. Will those be factored into the file that you currently have?

Mr. OLIAI. Those sources of data don't currently feed the credit file, but there are multiple offerings. It really depends upon which ones the lenders choose to employ.

Mr. GREEN. Is it safe to say then, when we have this nontraditional applicant, that we move from real-time to some time more? Is that a fair statement, if you are going to assess and use the alternative credit?

Mr. OLIAI. It is fair to a degree. It really does depend on the situation and how the lenders make their decision.

Technically speaking, if you are going to now go to another alternative source, that is another transaction, another data transmission. That would add to the transaction time. Would it add so measurably or significantly? Probably not. If the lender had—

Mr. GREEN. Are you equipped, are you established, are you set up to go to alternative credit scores immediately upon realizing their file is thin?

Mr. OLIAI. Experian is not set up to do that automatically today. We do have a third-party partnership in which, if the lenders choose to go that route, we can help them set that up.

Mr. GREEN. And that is time-consuming, I assume.

What I am trying to do is get a handle on how long, what does the process require in terms of time, when you move from traditional full file to alternative thin file? Can you help me with this, please?

Mr. OLIAI. You know, there is no rule of thumb per se, because it all is relatively new, and it really is dependent upon the lending criteria.

The data is available—well, to the degree that the data is available and pertinent to the decision, it can be brought in. And then it is incumbent upon the lender to determine how to base their decision on it.

Mr. GREEN. In every case, can you move to an alternative thin file if the applicant wants you to do so in every case?

Mr. OLIAI. That would be a function of what the lender or credit granter wanted to set up, as opposed to the applicant.

Mr. GREEN. So you are prepared to give us a traditional full-file result, and if we want something in the alternative, the lender has to give some judgment as to whether or not it is appropriate to do so. Is that a fair statement?

Mr. OLIAI. I believe that is a fair statement. "Appropriate" in the context of is it relevant to the decision, does it help align with their business strategies, etc.

Mr. GREEN. Do you agree that persons with alternative credit can pay bills and can perform to the same extent as persons who have the traditional full files—not all, but a good many can? It is just that you don't have the means of measuring them to the same extent that you do the persons with full files. Is that a fair statement?

Mr. OLIAI. I believe that is a fair statement.

Mr. GREEN. Okay. See, my concern relates to something that Mr. Wiermanski—and is that a fair way of pronouncing your name, sir?

Mr. WIERMANSKI. Yes, it is.

Chairman WATT. You just designated yourself as Polish.

Mr. GREEN. Believe me, folks have been trying to figure out what I am for years. Now I know. This hearing has been a blessing for me.

But, sir, you seem to indicate that people with thin files, they don't get the same benefits as persons with full files, and that some of these people may be minorities and women. Is that a fair statement?

Mr. WIERMANSKI. Yes, that is.

Mr. GREEN. Would you say that a good many of them are minorities and women?

Mr. WIERMANSKI. No, I would say that it—you are looking at a thin file right here. One of the few times I could be called thin is my credit report. So it really does encompass all walks of life.

Mr. GREEN. But, as is the case with most things, they impact some more than others. Do they seem to impact minorities and women more than others?

Mr. WIERMANSKI. I would say that, yes, minorities in particular and lower-income individuals would benefit more from full-file reporting from other—

Mr. GREEN. Or would they also benefit from an automated alternative credit scoring system comparable to the full-file traditional credit scoring system?

Mr. WIERMANSKI. From our perspective and based upon our analysis, TransUnion does accept utility information and other alternative data into our credit reporting system. So from our perspective, that information being added to a traditional credit report, not set outside as a different database, would actually make the credit processing quicker, more efficient, by having all the data in one repository.

Mr. GREEN. So you would recommend your system to those that do not have a system comparable to yours?

Mr. WIERMANSKI. That is correct.

Mr. GREEN. All right, my time is up. I will wait for the second round. Thank you, Mr. Chairman. I yield back the time that I do not have.

Chairman WATT. Ms. Speier, you are recognized for 5 minutes.

Ms. SPEIER. Thank you, Mr. Chairman.

Let me first start out by asking all of you if you are privately owned enterprises.

Mr. QUINN. No.

Mr. OLIAI. No.

Mr. GOERSS. No, we are not. We are publicly traded.

Mr. WIERMANSKI. TransUnion is privately held.

Ms. SPEIER. All right. And as publicly traded—none of you are Government-owned or -operated, correct?

Mr. QUINN. Yes, we are not Government-operated.

Mr. OLIAI. We are not Government-operated.

Mr. GOERSS. That is correct.

Ms. SPEIER. Okay. Each of you is required, of the credit reporting firms, are required to offer consumers one free credit report a year, is that correct?

Mr. OLIAI. That is correct.

Mr. GOERSS. Yes, that is correct.

Mr. WIERMANSKI. Yes, that is correct.

Ms. SPEIER. And how much do you charge for a credit score report?

Mr. OLIAI. At Experian, a score only, for VantageScore we charge $5.95.

Mr. GOERSS. At Equifax, for FICO's Equifax score, we charge $7.95.

Mr. WIERMANSKI. I apologize. I don't know that information, but I know it is included in our written testimony.

Ms. SPEIER. All right. And the FICO score that you would get from Fair Isaac, how much is that?

Mr. QUINN. Currently, $15.95 for the score and the credit report. We don't deliver score only to the consumer.

Ms. SPEIER. Mr. Chairman, I raise that because it is kind of interesting. At least back in December 2004 when I went through this exercise, what I found was that many of these scores are what are called "FAKO scores," not FICO scores, because they are not the scores that are provided to the lending institutions. So consumers may be purchasing something that they think is their FICO score but, in fact, is not their FICO score.

I will just read you very quickly the example of my credit scores at that time. From Equifax, I got a credit report plus a FICO score of 750. From Experian, I got a credit report and a PlusScore of 761. From TransUnion, I got a credit report plus a consumer score of 782. And then from FICO, I guess through Fair Isaac, I got a score of 731. So it actually varied by as much as 30 points.

I raise this, in part, because I think the consumers of America should be getting a straight score. And if, in fact, the score that is being offered by the credit reporting companies is not the score that is then given to a lending institution, then the consumer is paying for something that is of little or no value.

So I guess my question now is to you, as credit reporting companies, do you provide a different score to lenders?

Mr. OLIAI. There are so many scores that lenders use to underwrite a credit decision.

Ms. SPEIER. If you would, sir, just answer the question. Is the score that the consumer gets the same score that is offered to the lender?

Mr. OLIAI. In the case of the VantageScore, it is.

Ms. SPEIER. The VantageScore being?

Mr. OLIAI. Being a commercially available score that Experian sells.

Ms. SPEIER. You understand my question and are not evading it, I trust?

Mr. OLIAI. No. In the case of the VantageScore, it is. We also offer the PlusScore, as you pulled in your own experience, which is more of an educational score.

Ms. SPEIER. So the consumer typically is going to get a PlusScore and not the VantageScore?

Mr. OLIAI. It depends how the consumer comes in. It is pretty clear on the site which one to order, whether it is the Plus or the VantageScore.

Ms. SPEIER. And what is the difference in the pricing of the two?

Mr. OLIAI. The same price, as far as I know. I would have to check it, but I believe it is the same price.

Ms. SPEIER. All right.

Next?

Mr. GOERSS. For Equifax, we deliver the FICO score, which is a score that is used by lenders. We also advise consumers in the disclosure package that lenders do use a variety of scores and that the score we are providing may or may not be the score a particular lender uses in connection with their specific credit decision.

Mr. WIERMANSKI. TransUnion provides two scores to consumers, two different types of scores, both of which are used by hundreds of lenders making millions of decisions.

Ms. SPEIER. In California, there is a requirement that for employers who access credit scores or credit reports, that information

must be made available to the prospective employee and that the company, the credit reporting companies, must communicate with the prospective employee, so that if, in fact, they do have a credit report that is erroneous, they can at least make their case to the prospective employer when they have their interview.

Is that the case across the country?

Mr. GOERSS. Yes. For Equifax, when that was passed in California, we set up procedures to do that.

And one point for Equifax is also that we do not use or sell credit scores with the intention that they be used in employment decisions. We have a credit file that is called our Persona Report, which is intended for employment purposes. It does not have age, it does not have account number information and other information which we feel is not relevant or appropriate in the employment decision.

Also, as you know, the Fair Credit Reporting Act was amended to specifically change the procedures for employers using consumer reports. And we obtained certification from users of consumer reports or credit files for employment purposes that they do tell the consumer that they are ordering a credit report. If they are going to be taking an adverse action decision or there is a possibility that they might, that they, in fact, provide the prospective employee with a copy of that credit file so they can review it to make sure that it is accurate and, if they have any questions about it, can go back to the consumer reporting agency to have that information in it reinvestigated and changed, as appropriate, before any employment decision is made.

Ms. SPEIER. Is this the policy of Experian and not Federal law then?

Mr. GOERSS. This is Equifax.

Ms. Speier. I am sorry.

Mr. Goerss. And it is both policy and a requirement of the Federal law, as well as California law.

Ms. SPEIER. All right.

Mr. OLIAI. I believe our answer is that your statement is correct the way you said it. I would have to verify that for the record, but I believe that to be a true statement.

Mr. WIERMANSKI. This area is outside my area of expertise, but I believe that is TransUnion's approach. But I would certainly want to get back to you with the correct and full answer.

Ms. SPEIER. Thank you, Mr. Chairman. I yield back my time.

Chairman WATT. I am going to recognize myself for another round here.

The one legislative possibility that is being discussed, has been bandied around some, was touched on, I think, by all three of the reporting agencies, or at least two of the three. You are required under the FACT Act to provide one free credit report annually. And I think both Mr. Oliai and Mr. Goerss suggested that it probably is not all that helpful without a score. And there is a proposal floating around to require a free annual credit score, too.

The question is, what would be the public policy implications of that? And which score would you provide if you did? I am actually more interested in the first part of that, because I can get to the second question through a different question.

So how would you all react, the three of you, to a requirement that an annual score be provided? Or, actually, all four of you, since it would be a FICO score, too, I guess.

Mr. GOERSS. That is a point I wanted to clarify. I did not mean to leave the impression, if I did, that a credit file disclosure is not important for consumers, because—

Chairman WATT. Oh, yes, I am sure of that. But you did leave the impression that it would be helpful or that, for most people, really, it is helpful to them to have both at the same time. Isn't that right?

Mr. GOERSS. Yes, it is. I mean, as we know, the credit file is the information on which a score is based, so it is very important for consumers to review their credit file, make sure it is correct, and raise any questions about it so it can be reinvestigated and addressed as necessary.

Chairman WATT. Is there some reason we should not be considering doing that?

Mr. GOERSS. It was considered, as you know, by the Congress when it passed the FACT Act in 2003. And by a bipartisan margin at that time, Congress established the free annual credit file report. It considered score disclosure. It made score disclosure—

Chairman WATT. That is not a good reason, that a prior Congress didn't do it. Is there a good policy reason not to do it? What are the arguments against it? This is not a trick question. I am just—

Mr. GOERSS. I understand. I am not trying to give you a trick answer.

Chairman WATT. I am just trying to get some solid information here.

Mr. GOERSS. One of the things that we know is that, because consumer scores—in our score disclosure, we provide a telephone number that consumers can call and speak to live representatives—that credit scoring, because consumers are learning about that, it is a time of education.

Chairman WATT. So you are saying when you give a free credit report under the FACT Act, somebody can call and get a verbal score and have that explained to them for free?

Mr. GOERSS. Under the free credit file disclosure, we have a telephone number that consumers can call and speak to a live representative. When we provide score disclosure, either along with credit file disclosure, there is also a telephone number that consumers can call to speak with a live representative to get their questions that they may have—

Chairman WATT. You are not answering my question. I get my annual free report. Can I then call your company and say, "I want my score," and have you give it to me verbally, free, with an explanation? Is what you are saying, or is that not what you are saying?

Mr. GOERSS. At this time, no. Because we do have the score that is disclosed—the score disclosure provides a telephone number that consumers can call and speak with a representative.

Chairman WATT. I am going to run out of time again. Let me ask a couple of other questions here.

My VantageScore, interestingly enough, is the maximum you can get, 990. My Equifax score doesn't even begin to approach 850,

which is the maximum. I mean, how do you explain that? I am having trouble reconciling that.

And then, second, Mr. Wiermanski, in particular, I was very interested to hear you say, "I am a thin-file guy." That is kind of counterintuitive for a guy who is here testifying on behalf of a credit reporting agency. There has to be more to the story. What is the reason that you have elected to be a thin-file guy?

Okay, answer those two questions. I won't ask any more.

Mr. WIERMANSKI. If I can answer the first question, what is important in looking at and evaluating your credit score is not only understanding what that score is, but also the relative risk associated with that score. So for a VantageScore of 990—and I presume your other credit score from Equifax was a Fair Isaac score—what is used are odds of performance or a projected bad rate that is associated with the score.

And the scores themselves are kind of like you can think of Fair Isaac being Fahrenheit and VantageScore being Celsius. They are scored differently to reflect the risk, so you will see differences in the absolute value of the score itself. What is relative is to understand what is the risk associated with any given score or where you stack up in the random distribution of the country. Think of it as what percentile.

Chairman WATT. As you know, the problem I have with what you just said is I never have understood what Celsius meant. I know what it feels like when it is 60 or 70 degrees outside, but I don't have a clue what that translates into in Celsius. And if you came to me on a regular basis and reported to me in Celsius, I guess I would learn it. But the problem here is that there is no understanding that people have when they get these two things. I mean, I got a VantageScore, I kind of stuck my chest out and said, "Hey, I am doing all right. I have the maximum possible score that Vantage could give me." And then I got a Celsius score, and I said, I don't like that. It is the same temperature outside, I presume, but I don't understand it.

Mr. WIERMANSKI. Just to reiterate, there are different scoring systems out there. They vary by the developer. The scoring systems vary by the credit bureau. So if you were to get a score from the same developer from all three credit bureaus, you are going to see differences in scores because the information is different and the algorithms may be different. So that is a concern.

Chairman WATT. My time is up. I am dying to know why you are a thin-file guy.

Mr. WIERMANSKI. I am thin-file person because I paid cash for my automobiles. I have the benefit of having a working spouse, and so I could pay off my mortgage early. And I only use one credit card.

Chairman WATT. Have you made those decisions because you understand the intricacies and nuances of credit reporting, or have you made them for a whole different set of reasons?

Mr. WIERMANSKI. I made them from a standpoint of keeping my life simple and just having one credit obligation.

Chairman WATT. Okay. I appreciate your straightforwardness.

Mr. Barrett, you are recognized for 5 minutes.

Mr. BARRETT. Thank you, Mr. Chairman. I have found out one thing, Mr. Chairman. You have good credit. And I have a couple of used cars in South Carolina that I would love to talk to you about.

[Laughter]

Just one follow-up question.

Chairman WATT. I can't make any inquiries, though, because it might mess up my credit.

Mr. BARRETT. One question, Mr. Chairman, that I want to talk about.

The chairman makes a good point, gentlemen, when he talks about Celsius, that he doesn't know anything about it. Let me read you something. Last month's issue of the Journal of Financial Planning said that young adults under the age of 25 are now the fastest-growing age group for filing bankruptcy. In addition, less than 10 percent—10 percent—of our high school graduates take any course on money management.

I think that boils down to what the chairman—I mean, he was kind of joking about Celsius, but he makes a good point. You can read your credit scores, you can have this information, you can talk about it verbally, but unless you know how to keep your life in order, like Mr. Wiermanski, you are going to get in trouble.

So my question to you gentlemen is, what do we do as a Congress, what do we do as a society, to help this? There is so much information available out there, but yet when you talk to people on the street—I have town hall meetings—nobody knows how to access it, how to get this information that is free, that is readily available.

Tell me what we need to do, how do we fashion something so this subprime problem does not turn into an ongoing problem? Any suggestions, gentlemen, please.

Mr. OLIAI. For starters, the regular encouragement for consumers to take advantage of their annual free credit report I think is a great spot to begin. There is so much content and so much education out there on the Web that is available with that. Really, I can't think of a time in which there has been more transparency along the lines of tips for how to manage your credit. And I think that is at least a good starting point.

Beyond that, you know, encouraging broader outreach and education, whether it be on the part of lenders or, frankly, in the family, around how best to teach your youngsters how to keep things simple and keep things in check and not let things get out of hand. It really just strikes me as a bit of a back-to-the-basics approach.

Mr. QUINN. I think one of the things that we have tried to do is change the medium for how we disseminate the information. So there is a plethora of information out there on the Internet, but not everybody learns through reading a pamphlet or going to the Internet and reading text. So, more visually oriented educational materials—we have recently created CD–ROMs and DVDs to try to help spread the message of how credit scoring works. If you search the word "FICO" on YouTube, there are actually rap videos that are out there on YouTube about FICO scores.

But I think it is a good idea to explore different types of media that will resonate with the young population, for example. And it

is not going to be a piece of paper with a bunch of statistical mumbo-jumbo. It has to be something that they want to watch or read or see.

Mr. BARRETT. In our high schools, in our 2-year institutions and in our 4-year institutions, we require math, English, you know, a whole myriad of issues. Is that something—I am not saying mandate—but is that something we certainly need to encourage with our K–12 and our higher-ed institutions, that maybe this is something that we need to strongly suggest that our incoming freshmen, our seniors in high school take, Real World 101, how to pay your bills, what debt-to-income ratios are, yada, yada?

Mr. WIERMANSKI. I would agree with that. I personally speak at my daughters' high schools. I have two daughters, at two different high schools, and I speak there twice a year at each. And I am amazed as to the lack of understanding just about the whole gamut of financial services. I personally believe that is something that would help.

Mr. BARRETT. Thank you.

I yield back, Mr. Chairman.

Chairman WATT. Thank you.

Mr. Cleaver, you are recognized.

Mr. CLEAVER. Thank you, Mr. Chairman.

I am not going to talk about the class action lawsuits against the three majors, because I am sure you have all been told that you are supposed to say, "We can't talk about that because it is in court."

What I want to find out, though, is has there ever been a lawsuit filed on the other side? In other words, have you been sued on the other side by lenders for giving data that was ultimately seen as inaccurate and so some credit was rendered based on an inaccurate or inadequate information?

Mr. WIERMANSKI. At TransUnion, to my knowledge, and I certainly could be wrong on this, but we have never been sued about the information, the content of the information provided to a lender. We have been sued by lenders for other reasons, but not for the quality of the data.

Mr. GOERSS. For Equifax, it is not to my knowledge that we have been sued on that issue.

Mr. OLIAI. I don't know of a situation where that has happened, but it is not my area of expertise.

Mr. CLEAVER. Well, the point I am trying to get to, and perhaps poorly, is, are you overly cautious in the information you pass on to lenders in order to protect, if not yourselves from class action suits, from criticism from the people who ultimately pay for your existence?

Mr. OLIAI. At Experian, we take every protection to safeguard our core data. It is really our core asset, so we tend to operate very conservatively in that regard.

So that is a roundabout way of saying it is something we take very seriously. It is part of our culture to safeguard that asset and to be a steward of the data.

Mr. GOERSS. For Equifax, we want to, and feel we do, report accurate information that is fair both to the consumer as well as our

customers. And if our information wasn't helpful to both consumers and customers, we wouldn't be here today.

Mr. CLEAVER. Okay.

You are going to say the same thing probably.

Mr. WIERMANSKI. Only with more emphasis on the consumer.

Mr. CLEAVER. Okay.

I want to talk about Zoe Alexander. That is my maternal grandmother, who was obsessed with paying bills. But based on everything I have read, she would have access to no credit, because she didn't use the traditional system of doing her business.

And there are, believe it or not, people, particularly in the urban core, who do that today. There are not a lot of banks in the urban core, which is why Charlie's Quick Check-Cashing rip-off company exists, because there are no banks. And so a lot of people just take care of their bills with cashier's checks and money orders.

I mean, what is taken into account, or is there anything taken into account, for Zoe Alexander?

Mr. WIERMANSKI. When we talk about the reporting of utility information and telecommunication information, that is one approach where your grandmother could have been assisted.

At TransUnion, about 5 percent of our credit database has this type of nontraditional credit information being reported into it. And if utility companies and telecommunication providers, in particular, were encouraged to voluntarily contribute that data, I think that would make a big difference to the lives of many Americans.

Mr. CLEAVER. But it would have to be voluntary. I mean, that doesn't happen currently.

Mr. WIERMANSKI. Today's credit reporting system is a voluntary approach.

Mr. CLEAVER. Yes. What I am asking is, how often are the utilities factored in in a credit score?

Mr. WIERMANSKI. At TransUnion, if the utility information is reported, it is taken into consideration into the score.

Mr. CLEAVER. Yes. How often is it reported? That is the point.

Mr. WIERMANSKI. Approximately 5 percent of the consumers in our database have some type of information.

Mr. CLEAVER. Okay.

Anyone else?

Mr. GOERSS. And for Equifax, as I indicated previously, we have an exchange database with utility companies, so that information is used in a limited way in connection with telco and utility account and application processes.

Mr. CLEAVER. Of course, if that is all you have, you are still not going to be creditworthy. Even if you pay everything you have on time, but you simply have not gone out and had enough credit, you have not gone out and spent enough money on credit, you still are going to have a problem. Isn't that right?

Mr. GOERSS. We also have, in addition to this utility data that we use in a limited way, as was mentioned previously, we also have an arrangement with an outside third company, which is called RiskWise, that provides some information for individuals who have a thin file in the main credit reporting database or no file in that, and that RiskWise information is made available and can be used.

Now, to the extent that it would address all consumers, I am not prepared to speak to that at this point, at this time.

Mr. CLEAVER. Of course I would like to have a thin file because it also means that I have a rich file. I mean, you know, the thinner my file, the richer I am.

Mr. GOERSS. It certainly could mean that.

Mr. CLEAVER. Yes.

Thank you, Mr. Chairman.

Chairman WATT. Mr. Wiermanski is taking issue with what you just said. He says he has a thin file and he is not rich.

Mr. Green, you are recognized.

Mr. GREEN. Thank you, Mr. Chairman.

Some folks have thin files by choice and others because they don't have any choice, is my assumption. Is that a fair statement, Mr. Wiermanski?

Mr. WIERMANSKI. I would agree.

Mr. GREEN. Here is what I am concerned with. I would like to see a system, one system, it can have these various different captions on it, but that brings in the alternative credit as well as the traditional credit.

Is that something that each of you would like to see, as well? Would you like to have a world where we could have light bills, gas bills, water bills, phone bills, and rental payments all included in the one system?

If you differ with me on this, would you kindly extend your hand into the air so that I don't have to ask everyone?

Okay, let's let the record reflect that everyone would like to have a system wherein we can have all of the credit available included in the system.

Chairman WATT. I just want the record to show that the chairman raised his hand and he has some concerns with what is being proposed.

Mr. GOERSS. And I didn't raise my hand, but—

Mr. GREEN. Mr. Chairman, I think you started something.

Mr. GOERSS. I would say that we would provide some additional information on our thoughts on that.

Mr. GREEN. Well, I would like to hear your thoughts now, because I suppose that would give me the chance to do the follow-up right now. If we start exchanging letters, that could take us a while.

Mr. GOERSS. Well, as I indicated previously, there is a variety of information that we are looking at, that all of the credit reporting agencies are looking at, and they need to continue to study and determine what is the best use of that information. It could well be to put that in the one file system, as you suggest, but there may also be other approaches to it. And I am just saying I am not prepared—

Mr. GREEN. Well, right now it seems to me we have one company that tries to get as much of it as possible. Your company gets it, but you also have another way of evaluating it, and my suspicion is that is the same with the third company.

But what I am trying to find out is whether we can have all of the information available to you so that you can use whatever formula you use, whatever standards you use, whatever asset test,

but come to a conclusion with the information immediately available. Because with the alternative credit scoring, that is a two-step process, it seems. And I am trying to see if there is a way for us to have a one-step process.

So is a one-step process beyond the realm of probability, possibility? Is it doable? If you think that a one-step process is not doable, would you raise your hand, please?

Okay. Now let's let the record reflect that everybody thinks a one-step process is doable and that the chairman didn't raise his hand so far.

You are raising your hand?

Mr. OLIAI. Well, it is a mini-raise. It is not all the way, but it is halfway.

I think it is really an aspiration, a one-step process that you describe is an aspiration. And there are multiple perspectives that need to be explored.

You know, coming from a background of one of the guys who likes to build the models, the statisticians, the math geeks, the more data you have, the better. You can never have enough data to try all the different quantitative approaches to predicting consumer behavior. So that one-step process appeals to my nature in that regard.

Mr. GREEN. Now, one step, as I have defined it, means just acquiring all of the intelligence available, get the empirical evidence, and then you sort through it however you choose. But is there something inherently wrong with that kind of thinking, just have all of the empirical evidence and then come up with your own asset test for sifting the sand and finding the pearls?

Mr. OLIAI. I think it is a great aspiration. I think there are some practical hurdles to get over, not so much on the part of a company like Experian, but more so on the part of the providers of that information.

Mr. GREEN. I understand, but you would not oppose having the utility companies send you their information, would you?

Mr. OLIAI. Absolutely not.

Mr. GREEN. You would not oppose the landlord sending you his or her information, would you?

Mr. OLIAI. No.

Mr. GREEN. Okay. And if you had that information, would you place it into your asset test?

Mr. OLIAI. We would look to. We would do a compliance review and make sure that we are covered by issues of compliance and consumer privacy. But—

Mr. GREEN. Assuming it is done in the same fashion that you get your information from the auto dealership, that you get it from the mortgage company, assuming you have the same reliability standards, would you use the information?

Mr. OLIAI. Conceivably, yes.

Mr. GREEN. Well, why is it that you are reluctant to say "absolutely yes," for my edification, please?

Mr. OLIAI. Absolutely, yes.

Mr. GREEN. Okay. Thank you.

Mr. OLIAI. But, again, for the record—

Mr. GREEN. Absolutely, however.

[Laughter]

Mr. OLIAI. I am only here overnight.

[Laughter]

Mr. GREEN. You are only here overnight, but you have your boss forever, hopefully.

Mr. OLIAI. Again, there are some practical hurdles that aren't trivial to get over on the part of all involved. I think it is a great aspiration to manage to.

Mr. GREEN. Okay, the final question is this, and you may have to give me the answer in writing. I would like for you to tell me how we can best achieve what is a vision, that the notion that we would have all of this information available to you, how can we best achieve it, or get as close to achieving it as possible, assuming that it can't be done to the 100 percent standard. But I would like to know how we can best to achieve it. Because that really is what this is all about, trying to give everybody a fair opportunity to have a thin file if they choose to, but get the use of credit if they don't choose to and they still pay their bills.

Thank you, Mr. Chairman. I yield back.

Chairman WATT. Were you expecting a response?

I can give you a response. The problems are not necessarily on the reporting side; it is on the other side. Because with utility companies, for example, they are not normal users of the information, so their interest in making sure that credit scores are reliable—they almost have to give you a utility, right? They have a lot more vested interest in giving negative information than they do in giving accurate information, so you would have to deal with that. And a lot of these are much, much smaller providers of credit who are not in the habit of doing anything other than reporting negative credit information. So the problems are not so much—and the volume of it, if you mandated everybody to do it correctly, could be overwhelming.

I raised some of those concerns in the opening statement that I made just before you got here. It is a great vision, but it has some practical concerns associated with it that are not necessarily concerns about the modeling of it, which is what these gentlemen do in their companies, as much as it is some of the practical concerns from the providers of the information. Because they are only as good as the information that they are provided, even if their model is impeccable. If the information they get is not correct, it can be a negative for consumers as well as a positive.

So that was the concern I was raising my hand to express to you.

The gentlelady from California?

Ms. SPEIER. Thank you, Mr. Chairman.

To all of you at the credit reporting firms, how many free credit reports are actually requested per year as a percentage?

Mr. OLIAI. I don't have the specific number. It is something that the CBIA, our trade association, is compiling on behalf of the industry to provide to the committee, but I don't have the exact number with me today.

Ms. SPEIER. Well, my sense is it is probably a very small percentage. Is that a fair assumption?

Mr. OLIAI. I really dare not speculate.

Ms. SPEIER. Next?

Mr. GOERSS. Similarly, we are working with our trade association to provide the information. In terms of your question, you said a large percent, I am not sure that I am following your question. You said a large percentage of?

Ms. SPEIER. No, I am suggesting that it is probably a small percentage of American consumers who actually request their credit reports on a yearly basis for free.

Mr. GOERSS. Okay. Again, I don't have that specific information today.

Ms. SPEIER. All right.

Mr. WIERMANSKI. Again, I know that TransUnion produces tens of millions of free reports. We are working with our industry organization to provide that information.

Ms. SPEIER. All right. Both Consumer Reports and U.S. PIRG, last year and in 2005, did studies on the number of credit reports that had erroneous material in them. And U.S. PIRG, in a 2005 report, suggested that 79 percent of credit reports contained errors, and 25 percent contained mistakes serious enough to prevent the individual from obtaining credit.

So my question to all of you is, how quickly do you correct erroneous credit reports? How long does it take the average consumer to have their credit report corrected? And do you actually correct it, or do you put a note in the credit report that the consumer is disputing that information.

Mr. GOERSS. In terms of—it depends on the—to go through the reinvestigation process, the Fair Credit Reporting Act allows 30 days for that process to take place and for the reinvestigation to be completed and responded to the consumer. On average, I believe our reinvestigation completion times are in the 10-to-15-day range, and depending on the circumstances, depending on what the specific information is that is disputed, we may be able to correct it or address it at the time when the consumer is on the phone with our representative.

Mr. WIERMANSKI. This is an area outside of my area of expertise, but I would believe that TransUnion provides a similar type of turnaround time to correct this information as Equifax has stated—certainly within the guidelines provided in the Fair Credit Reporting Act.

Mr. OLIAI. I believe the same holds true for Experian.

Ms. SPEIER. So it certainly would make the case that consumers in America should feel very confident that if they have an erroneous credit report and they submit a correction, that that is corrected within a very short period of time.

It makes it seem like we have no problems. Excuse me for being a little cynical about that.

Let me ask you about identity theft. On average, how long does it take an individual who has had their identity stolen to be in a position where their credit report is then rectified to reflect legitimately their credit?

Mr. OLIAI. It is an area that I would have to look into and provide information back to the committee. I came more prepared to talk to credit scoring, per se, but we can get that information to you.

Ms. SPEIER. All right. Thank you.

Mr. GOERSS. I think part of it is, that is a very—there are a lot of different activities that a consumer can do to protect themselves if they feel they are victims or might be victims of identity theft.

Certainly one of the things that they can do is put a fraud alert on their credit file. They can receive a free disclosure of their credit file to see if there has been any inappropriate activity or inquiry to their credit file. They can provide an identity theft report and identify the account information that they feel, or that they say, was opened fraudulently. And under the requirements of the FACT Act, the consumer reporting agencies are going to delete that information; and the consumer reporting agency that receives that identity theft with information removal request is going to refer it to the other two consumer reporting agencies who are also going to remove that information.

So beyond, I think that whole process can move relatively quickly.

In terms of the specific timeframes, I am not prepared to address it. We would have to look back into that.

Ms. SPEIER. All right. Thank you.

I yield back.

Chairman WATT. I thank the gentlelady for her questions.

The Chair notes that some members have today asked and may hereafter have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record. There are a number of things that have already been put out, but it would be good to get follow-up, and we will follow up specifically on the percentage of people who are asking for their credit reports, the free credit reports.

This has been an absolutely fascinating and informative panel. I am sure it has helped to inform the members of the subcommittee, and the record will help to inform the members of the full committee. And the panel has informed the members of the public who have been watching on C–SPAN 3.

So it is extremely important that we educate the public about some of these issues, and we thank you so much for being here today and helping to inform us. This panel is excused, and we will call forward the second panel.

I thank these witnesses for being here today, and I will proceed with the brief introductions. The full, more complete information from your bios will be inserted into the record.

The first witness on this panel is Mr. Clark Abrahams, chief financial architect at SAS Institute Inc., a North Carolina-based company, I understand, so I need to give a little shout-out to the home folks.

The second witness is Dr. Michael Staten, a professor at the University of Arizona.

The third witness is Dr. Michael Turner, president and senior scholar at the Political and Economic Research Council.

And our final witness on this panel is Mr. Evan Hendricks, the publisher and editor of Privacy Times.

We thank all of you for being here. As we indicated to the earlier panel, without objection, your entire written statements will be

made a part of the record, and each of you will be recognized for a 5-minute summary of your testimony.

There is a lighting system in front of you. It goes to green initially, yellow at 4 minutes, and red at 5 minutes. Try to wrap up as quickly as you can after the red light goes on if you haven't completed your testimony, but we are not trying to cut anybody off here.

So, Mr. Abrahams, we thank you for being here and you are recognized for 5 minutes.

**STATEMENT OF CLARK ABRAHAMS, CHIEF FINANCIAL ARCHITECT, SAS INSTITUTE, INC.**

Mr. ABRAHAMS. Good afternoon, Chairman Watt, Ranking Member Barrett, and members of the subcommittee. I am Clark Abrahams, chief financial architect at SAS, a leading provider of business intelligence and analytical software. I appreciate the opportunity to provide my views on ways that we might improve our existing credit granting system.

Credit markets are influenced by what information is made available and tools that are used to manage and analyze that set of available information. I acknowledge today's ready access to historical information provided by the credit bureaus and the pioneering work by Fair Isaac. I have been privileged to work with all of them in my career.

The road to improving the current credit system is paved with greater information, illuminated by proper context, and built through collaboration. The comprehensive credit assessment framework, or CCAF, which I developed in the course of other risk research, integrates the positives from proven lending principles and the current system of credit scoring. This integrated approach capitalizes on the strengths that both proven judgment and best science offer to provide a comprehensive and complete view of risk.

CCAF treats a multifaceted decision-making process as exactly that, one that involves many factors that are interrelated. We build on the five "C's" of credit, namely, character, capacity, capital, collateral, and conditions. Each of these primary factors is comprised of several rating categories that are generically termed, such as "strong," "moderate," "weak," or "poor."

A loan applicant is rated according to objective criteria. For capacity, these criteria might include the borrower's debt ratio and savings rate. This is not an exhaustive list, but is meant to demonstrate the objectivity of the factors.

Once the borrower is classified, he is assigned a segment number and that number can easily be deciphered to reveal exactly where he stands relative to primary qualifications. Depending upon the borrower's primary givens, secondary factors or policy rules may be brought into play to render a final decision.

The CCAF is also adaptive by nature, it becomes more predictive over time, and from the day it becomes operational, the data set is constantly being increased and refreshed. As such, it does not need to be replaced at regular intervals.

We need to step back a bit from asking who is a predictable risk based on select historical facts or a lack thereof, and broaden the object of the exercise to ask, "Who is creditworthy and who is not?"

This question will drive other questions like, "Based on what?" One answer has been, "Whatever is in your credit file."

Similarly, should creditworthiness depend on how often we seek credit? Why should seeking credit cause greater risk? A model may indicate so. With any observed phenomenon, there are many supporting theories that can be posed. But theories are theories, and when we are trying to convince ourselves that a model is correct, then the theory can become all too compelling.

If consumers make other choices such as not using installment credit to make major purchases, does that or should that affect their credit standing? Why is a ratio of revolving to installment credit indicative of a borrower's willingness or ability to repay? Similarly, does the fact that the borrower lacks a history with credit truly suggest that such a borrower is less creditworthy?

An obvious question for consumers is, how can they know what impact any particular choice they make will have? To open or close a credit account, or apply for a loan, or decide to pay cash rather than finance a purchase, or how much they utilize their credit? Even with full disclosure, are we to tell consumers that being financially responsible means that they need to modify their behavior so as to maximize their credit score? The point is that an individual's creditworthiness should depend upon their ability and willingness to repay an obligation.

CCAF primary factors guarantee that all relevant information is considered versus giving that power to models.

Touching on the issue of borrowers with little or no credit history, there is data available that can be used to make reasonable estimates of their credit worthiness. This data is referred to as "alternative data," and it will be addressed in depth by my colleague, Dr. Turner.

Alternative data is crying out; we must allow it to speak.

In the beginning, we had guiding principles in lending that related creditworthiness directly to the borrower's ability to repay the loan. Then science came along and we determined that our models could find substitutes. CCAF revisits that fork in the road, and it retains reliable guiding principles while incorporating comprehensive information, including alternative data, in a single, overarching context with the best that science has to offer.

I appreciate the opportunity to be here today and I am happy to take questions.

[The prepared statement of Mr. Abrahams can be found on page 58 of the appendix.]

Chairman WATT. Thank you for your testimony.

Dr. Staten, you are recognized for 5 minutes.

## STATEMENT OF DR. MICHAEL STATEN, PROFESSOR, UNIVERSITY OF ARIZONA

Mr. STATEN. Thank you, Mr. Chairman, and members of the committee. My name is Michael Staten, and I am a professor in the Norton School of Family and Consumer Sciences at the University of Arizona and Director of the Take Charge America Institute for Consumer Financial Education and Research.

I have had the privilege of testifying before this committee previously over about 10 years when I was at Georgetown University. I am pleased to be able to join you again this afternoon.

From the consumer standpoint, maintaining a good credit score is more important now than it has ever been. We know that the rapid escalation in loan delinquencies and foreclosures has caused lenders to pull back, in some cases sharply, from granting credit to higher-risk applicants. The widespread adoption of risk-based pricing and consumer lending means that a low credit score will cost you money, possibly big money in the case of mortgage and auto loans.

In addition to tightening lending standards, lenders have also raised the bar for qualifying for the best interest rates. And we know, as has been pointed out earlier today, the credit score increasingly impacts consumers outside the loan markets as well. Landlords routinely pull credit reports and may reject apartment rental applications or require a higher deposit or cosigner to compensate for a lower credit score. Cell phone providers certainly pull credit reports on a routine basis, as do many utility companies. Some insurance companies and many employers do, as well.

Consumer awareness of credit reports and the importance of credit scores has improved in recent years, but much education remains to be done. Again as has been mentioned earlier this afternoon, the Consumer Federation of America partnered with Providian and Washington Mutual Bank to sponsor a series of surveys since 2005 to track consumer knowledge of credit scores. The latest edition of that survey released earlier this month found that only half of U.S. adults had obtained their credit score within the past 2 years.

Answers to other questions in the survey indicate a significant gap in the knowledge of how scores are used between those who have viewed their scores and those who have not. Overall, the survey indicates that a large portion of the population has yet to focus on management of their credit history and their credit score as part of their personal financial affairs.

In my submitted testimony today, I have tried to make two main points. First, business reliance on credit reports and credit scoring to make decisions about financial transactions is here to stay. Credit scoring has proved overwhelmingly superior to manual, judgmental loan evaluation systems of a generation ago. Widespread adoption of credit scoring is a decision tool that has generated significant benefits for consumers and has transformed the U.S. consumer financial markets into the most competitive in the world. Because they are so useful, scoring models have been constantly improving and will continue to do so as long as financial institutions compete for new customers.

My second point springs from the first. Because the use of scoring is so commonplace in financial transactions, consumers need to develop a better understanding of the importance of their credit histories and their credit scores and better awareness of their power to manage the components to obtain more favorable offers in the financial marketplace.

Credit scoring is no longer the impenetrable black box that it may have appeared to consumers as recently as 2001. Even prior

to the FACT Act in 2003, the major consumer reporting agencies and scoring model vendors had recognized a marketing opportunity and began to view consumers as customers of scoring information products, including a host of credit score monitoring and ID theft alert services.

Today, numerous Web sites, originated in both the public and public sectors, provide consumers advice on how to understand their credit reports and what goes into determining their credit scores. Managing a FICO score, for example, into the 700 Club has gained a bit of a cult following with advice flying around the Internet regarding how to manipulate account balances and manage existing accounts to tweak a score to a higher level. Yet, according to the Consumer Federation of America surveys, a large portion of U.S. borrowers still don't understand what a credit score represents or the factors that determine a score.

Far more important than coaching consumers to tweak their scores, it seems to me that the bigger policy challenge is to make a large proportion of American borrowers aware of the following points:

First, failing to properly manage a credit score costs you money and, again, sometimes big money. Fair Isaac's myFICO.com Web site provides ready examples of loan rates that correspond to various score ranges. The cost differential between low scores and higher scores can easily translate into hundreds of dollars per month in additional finance charges for larger loans such as home mortgages. It can also cost you opportunities for apartments, jobs, insurance, and similar services. Credit scores really matter.

Second, your credit score can be managed. You don't have to accept it passively. Your credit score reflects your decisions. Consumers have the ability to raise and lower their scores. Because credit scores reflect a consumer's own past payment history and current use of credit, consumers can control their own score to a large degree, especially over time. This makes a credit score an important, but underappreciated personal financial management tool.

Third, I would say to consumers, knowing your own score and knowing what lenders consider to be a good score and a poor score helps you shop and recognize a good offer from a bad one.

And lastly, a consumer's FICO and VantageScore credit scores are based solely on information in their credit report. So I would say to consumers, check your credit report periodically to see what is there and be sure what is there is correct.

Thank you for the opportunity to contribute to the discussion.

[The prepared statement of Dr. Staten can be found on page 140 of the appendix.]

Chairman WATT. Thank you for your testimony, Dr. Staten.

Dr. Turner, you are recognized for 5 minutes.

**STATEMENT OF DR. MICHAEL TURNER, PRESIDENT AND SENIOR SCHOLAR, POLITICAL AND ECONOMIC RESEARCH COUNCIL (PERC)**

Mr. TURNER. Good afternoon, Chairman Watt, and Representative Barrett. Thank you both for the invitation to testify.

My name is Michael Turner, and I am the president of the Political and Economic Research Council based in Chapel Hill, North

Carolina. PERC is a nonprofit, nonpartisan policy research organization that focuses on market-based economic development both in the United States and globally.

As highlighted in an earlier PERC study that was presented to Congress in 2003, the pervasive use of automated underwriting solutions and consumer credit has yielded considerable social and economic benefits. However, the system is not perfect.

Specifically, it is often difficult for consumers to enter the credit market. To start down that path, you can't get credit because you don't already have credit and you don't already have credit because you don't have any credit history. This is the credit catch-22 confronting many potential first-time borrowers.

Several recent developments have started to ease that transition for millions of Americans. Specifically, because of the increasing availability and acceptance of so-called "alternative data," millions of Americans are now facing a shortened path to entering the credit mainstream.

Traditional consumer credit files generally include records of credit and payment obligations between individuals and creditors, typically financial organizations or retailers. "Alternative data" are other payment organizations from nonfinancial institutions that are generally not reported at all to credit bureaus or are underreported. Some of the more prominent alternative data sets include energy utility, telecoms, rental remittance, and insurance payment data.

While tremendous strides have been made in making credit access both fairer and more affordable, there remain an estimated 35 to 54 million Americans who are outside the credit mainstream owing to insufficient credit information about them. Because of this information gap, many Americans still cannot be scored.

Without a score, the two primary means by which most Americans build assets and create wealth, homeownership, and ownership of a small business, are not attainable. In this context the lack of sufficient data in a credit file acts as a barrier to wealth creation, opportunity, and social and economic advancement.

The good news, however, is that the world is changing and changing rapidly. The tens of millions who might otherwise have been left outside the mainstream are finding that payment data reported by nonfinancial organizations is thickening their files and increasing their attractiveness to lenders. Rigorous empirical testing by PERC and the Brookings Urban Markets Initiative yielded irrefutable evidence that energy and telecoms payment data are predictive of an individual's credit risk.

PERC and Brookings UMI examined a sample of over 8 million TransUnion credit files that contained one or more fully reported utility and telecoms payment tradelines. The key findings of the PERC Brooking UMI report are compelling. Those with thin files have similar risk profiles as those in the mainstream.

Fully reporting alternative data broadens and deepens access to affordable mainstream sources of credit, especially for thin file and no file borrowers. Fully reporting energy utility and telecoms payment data reduces bad loans. More comprehensive data can improve scoring models. The problem that remains is that this data is not yet widely reported.

Energy utility and telecom firms have two primary direct incentives to report accurate data. The first pertains to operating costs. As the rate of inaccuracy rises, customer service and administrative costs to the furnisher providing the inaccurate data will also rise. Firms have a compelling market incentive to control costs, making it unlikely that any firm with a higher error rate in the payment data reported to a credit bureau would continue to report without improving accuracy.

The second direct incentive concerns improved cash flow. According to PERC's recent survey, energy utility and telecoms firms fully reporting to a credit bureau witnessed a decline in delinquencies and charge-offs. This reduction has a positive cash flow impact. Respondents to the forthcoming PERC survey also indicated that the perceived benefits from reporting outweighed costs. Reporting inaccurate data would fundamentally alter this cost-benefit equation.

Just yesterday, PERC released a new empirical study entitled, "You Score, You Win" at the National Press Club that specifically addresses concerns about alternative reporting data. The key findings are, there is no evidence that those who open new accounts after having only nonfinancial accounts become overextended. There is no evidence of deteriorations of credit score over time for those with nonfinancial payment data in credit files. No empirical evidence supports the notion that chronic late payers would be harmed by fully reporting energy utility and other payment data. And all evidence suggests that reporting payment data serves both as a consumer protection and as a wide protection.

Congress can play a role in helping achieve this socially and economically optimal outcome. They can work to help remove statutory barriers, including the perceived prohibition on sharing positive data contained in section 222 of the Telecommunications Act of 1996 that some telecom firms have unfortunately interpreted as permitting the reporting of only negative payment data, but not positive payment data.

Congress could consider passing a law permitting energy utility and telecoms companies to choose to report their customer payment data. This would remove the most significant barrier identified by NARUC in a State, that of regulatory uncertainty.

Finally, Congress could use their bully pulpit to act and to exhort and incentivize energy utility companies to fully report.

Thank you for this opportunity to testify.

[The prepared statement of Dr. Turner can be found on page 153 of the appendix.]

Chairman WATT. Thank you for your testimony. I didn't realize that you were based in North Carolina, too. I should have given you a shout-out, as well.

Mr. Hendricks, you are recognized for 5 minutes.

## STATEMENT OF EVAN HENDRICKS, PUBLISHER AND EDITOR, PRIVACY TIMES

Mr. HENDRICKS. Thanks you, Chairman Watt, Ranking Member Barrett, and members of the committee for the invitation. My name is Evan Hendricks, and I am in my 28th year of publishing a newsletter called Privacy Times.

I have been in Washington a long time. And I am also the author of a book called, "Credit Scores and Credit Reports: How This System Really Works, What You Can Do." And in the spirit of the book, I will try and speak on behalf of the millions of consumers who all have credit reports, either full files or thin files.

Mr. Chairman, you have planted a very powerful seed today, and that is the idea that we should be entitled to one free credit score per year. I think the answer to your question, is there a policy reason not to do that, is, no, there is no good reason not to do it. We should do it. To do it right, we have to seriously understand how the system works, and we have to talk about what I am calling the "secret sauce," and we will get to that in a minute; but to make this a meaningful score for consumers, there is a secret sauce in the system that we have to deal with.

Now, right now, you take it for granted that we know about credit scores. But you have to remember what it was like 12 years ago in the mid-1990's when credit scores started being widely used. They were a complete secret; the industry did not even acknowledge their existence. Then, when they found out about it and reporters like Michelle Singletary of the Washington Post started reporting on it, then they would not disclose the score to you.

Then California led the way with a State law, and now we have the FACT Act, which means that you can get one, you can buy a credit score for a fair and reasonable price.

Mr. Chairman and Congresswoman Speier put their finger on some very important problems, first, the problem that they are selling knock-off scores, or FAKO scores, ones that are not used by lenders. And so consumers are paying for scores. And we have lots of anecdotal situations where this consumer tries to be educated, they buy their score, they go out there; and then when they apply for credit, they find their score is much lower and so they are in a very disadvantaged situation.

And, Mr. Chairman, the Fahrenheit versus Celsius problem is a very real problem because the industry has created a very confusing situation here because we have the standard FICO score, which is used by about 75 percent of the lenders, that is the one most widely used. And then they sell you the PLUS score, and the TrueCredit, or TransRisk score, has a range that goes up to 950; the VantageScore, which all three have created, goes up to 990. And there is very little evidence of market penetration by those scores, and I hope that they produce some numbers on that.

But I think maybe, probably the most profound problem is that as far as we have come, consumers cannot buy or get access to the actual score on which they are judged.

Let's use the mortgage setting as an example of this. When you apply for a mortgage, the broker, the lender, goes to a reseller, they pull a Tri-Merge report—your TransUnion, your Equifax, and your Experian—and they merge them into one report, and you get three FICO scores, one from each bureau. And those are the ones you are really judged on. So even when you are buying a FICO score from Equifax, the one you are being judged on is probably based on a different model. The ones you buy for yourself can give you a good idea, but there can also be significant differences.

So when we are talking about consumers really understanding where they stand, we need consumers to have access to those scores and also access to those Tri-merge reports.

Now, the reasons that those are a subscriber version of the reports, those are the most meaningful version of the reports; and I will explain a difference here in the minute that I have left.

Right now, consumers cannot get access to those reports because the resellers that compile them are barred by contracts from showing them to the consumer. Now, in the FACT Act it used to be they could not show the consumer anything after the fact. The FACT Act already changed that, so after the fact they can show you.

Now we need to make it so consumers can see this information before they apply for credit. The reason this is important is that they also use algorithms to decide what information goes in your report when you apply for credit versus when you get your own. When you ask for your own report, they use very precise algorithms to make sure that information really deals with you. But when they are selling a report about you to a creditor, they use looser, partial-matching algorithms, so if something might relate to you, they are going to make sure it is included on that report because they don't want to miss out on anything.

Instead of maximum possible information—or accuracy really is maximum possible information—those are the reports that consumers need to get access to; and these resellers, the network of resellers, is a wonderful place to start. Including getting scores that are meaningful, we just have to override those contracts through national policy and bring more transparency and fairness to the system.

Thank you. I yield back the rest of my time that I don't have either.

[The prepared statement of Mr. Hendricks can be found on page 119 of the appendix.]

Chairman WATT. Thank you so much.

And I thank all of the witnesses.

The members of the subcommittee who have been here have been absolutely diligent, and they have been here throughout. So I am going to reward them by going last in my questions to this panel, since I have to be here anyway, and some of them may, because we went two rounds, have other competing appointments.

So, Mr. Cleaver, I am going to recognize you first for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

I want to go back to the issues I raised with the previous panel. And one of the questions that I raised—I am just curious as to whether or not any of you would have a different response—and that is, is there a correlation between the place of residence and credit scores?

And, specifically, I think my question is, in areas of high minority concentration, the study I have suggests that they have worst-ever scores. And if credit scores have a disproportionate impact on residents in communities with high minority concentrations, what other socioeconomic factors might account for this reality?

Mr. HENDRICKS. Well, I am familiar with the Missouri study, and I think it is a very useful study, though its controversial. Industry doesn't like it.

Mr. CLEAVER. Well, yes.

Mr. HENDRICKS. But it showed that there was disadvantaged credit scores in disadvantaged communities. And I think that is—you know, I compare credit scoring—I agree with Professor Staten, it is something that is here to stay, so I think we have to understand and deal with it.

But it is a lot like SAT scores. SAT scores are sort of a test created by a circle of people which is meant to measure a certain kind of skill. And the credit scoring system is kind of the same way.

And so there are people who are extremely responsible in paying their bills, but if they are not plugged into our surveillance system of credit, then they don't get the credit in terms of a good credit history and good score.

And so if you have a thin file and then you also have a late payment on top of it, then it is a double whammy that sends your score down more because part of your score is based on good news, and if you are a disadvantaged community, it is much harder to build up the history of good news that will give you a buffer in case the bad news comes.

So that is why I think it is a useful study.

Mr. CLEAVER. Do minorities and poor folks have worse credit scores regardless of the geography?

Mr. HENDRICKS. I don't know. I think the actual research shows that there are people from disadvantaged communities who have good credit scores, too. But that means that they basically play by the rules of that system of building credit, avoiding late payments, not maxing out their credit cards.

That is kind of a tall order in today's society, though; and so I think you are going to see falling median levels of the population's credit scores.

But I think clearly we need especially targeted presence in programs and education. Because now getting credit is going to be imperative to any sort of social mobility, and so people have to understand how the system works and how they can use it or find the alternative system that will give them a chance.

Mr. CLEAVER. Well, "alternative system," I am glad you mentioned those words. Why do we have, essentially, three credit rating agencies?

Mr. HENDRICKS. That was a result of business evolution. We used to have five major ones, and merger and acquisition made it so we have the three that we have today.

Mr. CLEAVER. Do we need more than three, or is there a reason to make some adjustments in the three we have that would allow the underserved communities to have greater access to credit?

Mr. TURNER. If I could respond to that, the national credit reporting system certainly is an evolving system; and as I mentioned in my oral statement and in my written prepared statement, the phenomenon of automated underwriting has absolutely, by every measure, made lending broader and deeper and fairer. And as I also mentioned, it is not perfect.

And, of course, I was asked to speak about the promise of nontraditional or alternative data; and I actually agree wholeheartedly with Evan's observation that having this data reported in greater volumes would actually help mitigate the adverse consequences of

a negative in a delinquency or default for thin and—well, for thin file, particularly, individuals.

So the system is evolving. You have seen niche players move into this market. Four years ago you could probably count the number of them on one hand. PRBC was a pioneer. Now we have link-to-credit, Experian, Equifax—or Experian and TransUnion are certainly making great strides in this. But it is a slow process.

We have worked on the demand side. The study that PERC provided actually brought lenders and the bureaus together to understand the payoff for using alternative data for risk assessment. The issue now is that we have to make a business value proposition to energy utility and telecoms firms to report the data because they absorb very real costs under the Fair Credit Reporting Act in terms of data furnisher obligations.

We have a forthcoming study. We have surveyed a large number of energy utility and telecoms companies with the American Gas Association, the Edison Electric Institute, TransUnion, and Experian. We will be providing those results in the next quarter.

But it is a challenge. Our hope is to realize that aspiration. So it is an evolving system, and I think strides are being made.

Mr. HENDRICKS. And I think the answer to your question too is, the credit reporting system is basically built to collect the information behind your back and then the information surfaces when you try and make a credit move. In other words, it is sort of a "gotcha" system.

So one policy or goal would be to have one credit reporting agency that would be more a consumer-facing reporting agency. And I think Dr. Turner has cited pay rent—you know, PRBC is one where it is an opt-in approach—and others. So I think we do need alternatives, and we need to have it so consumers are plugged into their own information as much as all those thousands of creditors are plugged into it.

Mr. CLEAVER. Mr. Chairman, one of my hopes is that some time later we will have another hearing. But I certainly would love to have an opportunity to read the study that Dr. Turner spoke of that will come out in the next quarter.

Mr. TURNER. We would also be happy to provide, if you are interested for the record, our report from just yesterday that empirically speaks to some of these questions as well.

Mr. CLEAVER. Yes, I am very interested.

Thank you, Mr. Chairman.

Chairman WATT. We certainly would welcome that report.

And for the gentleman's information, I don't think there is any anticipation that there will be any legislative moves on this issue this year. So we have a period of time to get forward-looking information that is in process now.

Mr. Barrett is recognized for 5 minutes.

Mr. BARRETT. Thank you, Mr. Chairman. Drs. Staten and Turner, can you kind of elaborate on the effect of credit scores on our senior citizen population?

Mr. STATEN. Well, it basically has the same effect as it does for the rest of the population. It is built on past experience, experience with credit, repayment of credit. There isn't any particular bias in the credit scoring models with respect to senior citizens; and in

fact, if anything, the Federal Reserve Board's study last year suggested that if there is an age bias at all built into the standard scoring models, it tends to look at files and take time on file as an indication of or a proxy for age. Senior citizens who have used credit in the past probably have a very long time on file, and it probably counts very much to their advantage.

Mr. ABRAHAMS. I would offer that actually in cases where there is loss of a loved one and the major spouse who had the credit history passes on, then the widow or widower may experience some issue there. So that would be a factor.

Mr. TURNER. And I would add to that, in fact, one of the key findings from our previous studies with Brookings UMI was, a significant number of above-66 individuals who had a thin file. And so we see, actually, great promise in having the energy utility and telecoms payment data in assisting elderly individuals who, in fact, as Clark notes, we have an increased incidence of late-stage divorce and the widow-widower effect.

And our actual numbers were corroborated by another study done by one of our supporters for that study, which was GE Money, and they came up with almost the exact same percentage. So there is an issue that we think alternative data reporting can actually help resolve.

Mr. BARRETT. And, Dr. Turner, while I have you on the line here, I know that we have talked about credit scores, and there is a lot of hemming and hawing about whether it is the right thing, or factors we take into it. But out of all the findings that we have seen, would you agree that, using some type of scoring system, you get the most accurate predictor of risk, fairness, affordability, the whole 9 yards of any system that is out there today?

Mr. TURNER. Well, again, we have advocated as part of our alternative data initiative having data reported directly to credit bureaus and consumer reporting agencies.

I think—and if I understood correctly the one system that Representative Green alluded to—that has been our stated objective. We think that is very efficient.

TransUnion has been on that path for a long time. Certainly, Experian and all the bureaus are looking at that at this point.

Mr. BARRETT. And the last thing I want to—Mr. Chairman, we have talked about—Mr. Hendricks brings up some very wonderful points, but isn't the key for the consumer education—I mean, didn't he or she need to know all there is no know about the scores, how they are obtained, how it affects them?

And again, let me pose this same question to you guys. I know you all heard it all from the first panel, how, as much as is out there, so many people still don't understand what is going on. How do we impart that information to the average citizen?

Mr. HENDRICKS. Well, it has to be a multifront attack, and I have written a book; you are holding a hearing, you passed the FACT Act. All these things have contributed to it.

Again, in my 30 years following this, I am still optimistic because, again, 12 years ago, they weren't even acknowledging there were credit scores. Now we are deciding between which color is best and which best serves consumers.

So I think the idea that—like the State attorneys general have gone around their State holding identity theft things which relate to credit scores, the 13-Town Tour. You are talking about going to your community at teleconferences with your community. I think it is like giving it every chance we get and, you know, a concerted push.

There is supposed to be a financial literacy push as part of the 2003 FACT Act. I don't think that has the aspirations that it is supposed to. But I think, now it is not just interesting, it is vital for people.

So I think in terms it is worth public policy, it is worth resources to go into our communities, starting with the high schools, and really make a concerted effort that this is pocketbook stuff and people need to understand it.

Mr. BARRETT. Absolutely. Thank you gentlemen.

I yield back, Mr. Chairman.

Chairman WATT. I thank the gentleman. I am going to report to my ranking member that he should have a substitute for him all the time.

The gentleman from Texas, Mr. Green, is recognized.

Mr. GREEN. Thank you again, Mr. Chairman. Let's start with Mr. Abrahams.

Sir, you have seemed to intimate, if not state, that a comprehensive system, while not necessarily perfect, is still a better system on balance than what we have currently if you want to extend credit fairly to everyone.

Is that a fair statement?

Mr. ABRAHAMS. I would say that is a fair statement, yes.

Mr. GREEN. And you have heard some of the indications about information collected about utilities and landlords and persons who are without what we will call the "traditional reporting system."

How is it that your standard or your asset test, this equation that you have developed, how is it that it can tweak the process such that you get results that are consistent?

Mr. ABRAHAMS. It would first classify the borrower or the loan applicant. So we talked about the Celsius and the Fahrenheit. That is because the credit score is an odds quote. That is what a credit score is. We are not giving the consumer—we are not giving the consumer the scale, but we are giving him the odds, if you will.

I am advocating a system where we would have a classification to the consumer that would be decipherable, so you would know precisely what your position was relative to the primary factors of the loan decision. And it is much more difficult and challenging for score card developers to provide that kind of information because of the secret recipe.

Mr. GREEN. And, Mr. Turner, you gave some information concerning this as well. It seems to me that you are of the opinion that reporting all of this information as much as possible makes sense.

Is that a fair statement?

Mr. TURNER. It is a fair statement, but I would recognize the chairman's caveat that there are certainly going to be road bumps along the way.

Mr. GREEN. Is there a means, a methodology, by which the road bumps, while they are there, they can still be factored into the

equation and you can still service people who have only nontraditional credit?

Mr. TURNER. Well, I think the market is responding. I think you are seeing, in fact, a number of models that rely heavily on nontraditional data for credit positioning purposes. And certainly to the extent that the volume increases—

Mr. GREEN. I am going to take it from your answer, that is "yes."

Mr. TURNER. Yes.

Mr. GREEN. Okay. Just so that I can move on, must you report to the agency to benefit from the information that the agency has? For example, if I am a landlord and I would like to use credit information, do I have to report information to the agency to use the information that I can receive?

Is there reciprocity involved in this process, is what I am asking.

Mr. TURNER. Well, there are a number of alternatives available right now, and some emerging.

Actually, we are working currently with TransUnion's rental screening services and testing the validity of using rental payment data and credit risk assessment. Similarly, with a group in Atlanta, a rent bureau. This data is just being collected now; it just really didn't exist in numbers before.

But also pay rental credit has an opportunity for individuals to work through lenders to have lenders report payment data to a third party to make credit decisions as well.

So there are a number of different alternatives.

Mr. GREEN. You indicated earlier that more and more landlords and nontraditional users are now starting to use these scores, correct?

Mr. TURNER. That is correct.

Mr. GREEN. If they are using the scores, is that a means by which we can induce them to also present information that is accurate?

I am trying to find a means by which we can inculcate them into the process without making it mandatory. If you want to benefit from it, let's have some reciprocity of participation from you is what I am leaning toward.

Mr. TURNER. I would suggest—again, I think that TransUnion would be better situated to talk about their standards on this. But clearly, all the bureaus have data quality standards for taking in new data.

It is not just that you may report and the bureaus have to take it. There are certain standards for quality that are in place already. And I think that there are a number of low-hanging fruit, particularly among the energy utility and telecoms firms that are very large, have sophisticated databases and billing cycles and can report very high quality data that is verifiably accurate.

Mr. GREEN. I understand.

It seems to me—and I will come to you in just a moment, Mr. Hendricks, because I am interested in what you have to say. But it seems to me that if more and more companies are moving toward these scores and they are utilizing these scores, if we can encourage them to not only benefit from the score, but also to have reason to participate in the process by virtue of benefiting from the score, we can inculcate them.

Is there something in that logic that I need to better understand?

Mr. TURNER. No. I agree, and that is what we are trying to show. We are trying to basically show the business value to prospective furnishers from reporting; and that is what will get the buy-in into the system and why they will report accurate data.

Mr. GREEN. Mr. Hendricks.

Mr. HENDRICKS. I wanted to answer your question.

Right now, there is not really reciprocity. Even the Act defines that there are furnishers of information to the credit reporting agencies, and then there are users; and you don't have to be a furnisher to be a user.

I think the way to go is to let this be a consumer-driven thing to the extent that to have—let's say, as an example, the utility company—they can tell their customers, we can report data about you to consumer reporting agencies if you opt into this. If you do, these are the benefits that are going to be.

The problem, if we did this en masse, top down, is that we have gone decades and decades where people don't expect information on utilities to be reported to credit reporting agencies. So if there are people who generally pay on time, but had a few late payments, but had a thin file, then all of a sudden that is going to hurt them rather than help them.

Mr. GREEN. Because my time is up, let me share this. I think I comprehend what you are saying. You are saying that this is an evolutionary process, and it may metamorphose into something comparable to what we are talking about.

But, listen, one more thing before we leave this. I am concerned about those who are left out of the process, and that is what all my questions have been leading to.

How do I get them, those who really do pay bills, but don't have this traditional credit, how can they benefit from credit? Because you made it transpicuously clear that it pays to have good credit. I mean, you save money, you can then have wealth-building by some other means. That is the concern that I am trying as best as I can to extract from you: How do we get to this point where we can do this?

And I think I am hearing you say "comprehensive"—that is the term you used—comprehensive reporting makes a difference. You can't compel it, but there may be a way to entice it. Is that a fair statement? Does anybody differ with me on that, don't compel but entice?

And before I yield back, what do you perceive to be the most efficacious methodology for enticement?

Mr. TURNER. We would encourage clarification on section 222 of TA-96 and permit—pass a law that permits utility companies and telecoms firms to report payment data to bureaus and CRAs.

There is a lot of regulatory uncertainty in the States. There are utility companies that want to report that have been told "no" by their PUC or PSC despite the fact that there is no statutory prohibition. And we found out that many regulators believe that this data will be used for marketing, which is incorrect because the FCRA explicitly prohibits that. So there is an issue of regulator uncertainty.

There are States right now—we are working in California and we are working in Illinois—there is a great interest in California and a great interest in Illinois in doing something legislatively or regulatorily that will promote this reporting.

Mr. GREEN. Mr. Chairman, I don't know if this is something that is already being reviewed by a committee member or someone else. But if it is appropriate, perhaps my office can work with the good offices of Mr. Turner and try to craft some language.

Now, I am not sure that we are the committee of jurisdiction for that.

Chairman WATT. We are not the committee of jurisdiction. And the gentleman may be surprised to know that he is the leader on this issue. You really are. I mean, I think perhaps you and Mr. Castle have probably taken more leadership on the issue of alternative data than anybody else on the committee or the subcommittee.

So it was through your efforts that we made that a part of the hearing today, in fact, at your urging and Mr. Castle's urging. And I am glad we did because my initial inclination was not to, because I thought it was a sufficiently different subject that would just confuse people.

I think it has really been an enlightening discussion, and I would encourage you, as we develop questions, follow-up questions, to submit in writing to this panel and the earlier panel to aggressively think through some of the issues that you have put out there; and let's build a record on it. We won't be the legislating subcommittee, but our whole purpose is to build a legislative record for the committee of jurisdiction, the subcommittee of jurisdiction, or the full committee, to act on this.

So this is the place to do it, and you are the leader on it, whether you know it or not. Whether you like it or not, you are the leader on it.

Mr. GREEN. Thank you, Mr. Chairman. Sometimes I am better than I realize I am. Thank you.

Chairman WATT. You just don't know what your power is.

Mr. GREEN. Mr. Chairman, if I may ask unanimous consent to give a quick response?

I am more concerned about—section 222 of the Telecom Act of 1996 is what I think was referred to. I am not sure that Financial Services is the committee of jurisdiction to deal with an amendment.

Chairman WATT. It sounds like, from Dr. Turner's response, that there is no real—that the problem is a lack of clarity. There is not a directive that says they cannot do it; it is just that a number of them have found it in their interest not to do it, and they are using the lack of clarity to hide behind, as I understand it.

Is that correct, Dr. Turner?

Mr. TURNER. Actually, in this case, there was a major telecom firm that did fully report to all three bureaus. But internal counsel conservatively interpreted the FCRA carve-out in section 222, because the prevailing practice at the time was reporting only negative data, and they felt they could be exposing themselves to class action litigation for being in violation of Federal law.

Chairman WATT. And that is one of the concerns that has been raised about it. Unless you put some parameters around it, only the negative data that will adversely impact people's credit, not the positive data that will enhance their ability to get credit, will be reported.

And in response to Mr. Hendricks' comment, one concern about an opt-in or opt-out approach has been if you opt out, certain lenders will view that as an indication that you are admitting that your credit was bad, and they will use that against you. So I mean, you kind of meet yourself here coming and going.

But I think you have to pursue it because you and Mr. Castle are the—I am not just humoring you publicly here—you are the leaders on this issue.

Mr. GREEN. Thank you, Mr. Chairman.

Chairman WATT. The gentlelady from California is recognized for 5 minutes.

Ms. SPEIER. Thank you, Mr. Chairman.

And thank you to our panel, and a special hello to Evan Hendricks with whom I have had the pleasure of working over a number of years.

I am going to share, Mr. Chairman, my bias. We call these credit reporting agencies or credit bureaus, which gives the average consumer the impression that they are dealing with some Federal entity, when in fact they are not. We heard this afternoon they are privately or publicly traded companies.

And yet this information is so critical, and to Mr. Barrett's comments, who suggested that the consumer needs to be educated, needs to know what goes into their FICO score and what they can do to improve their FICO score, we can't give those kinds of answers because, for all intents and purposes, it is a proprietary formula. It is sort of like a secret sauce; we don't know what it is.

Now, there is something wrong when the government can't articulate what should be considered in a FICO score. I mean, the fact that we are talking about enticing these bureaus or agencies to include alternative information is, I think, pretty weak. And I hope, Mr. Green, you will make it compulsory, because I think that is part of what we should be looking at, a complete picture.

Based on what has been said here, more companies are coming into the market, which means we will have more FICO numbers, not fewer; that consumers are going to be buying numbers that may or may not be the numbers that are being used by their lenders; that, in effect, over the long-term we are going to have more subjectivity as to who gets what premium or who gets what mortgage at what interest rate because these numbers aren't the same for everyone based on a specific set of indices that are used.

So here is my question, and let me start with Professor Staten.

We will have, it is anticipated, 5 million Americans who will be foreclosed on in a very short period of time. What are we going to say to them if, in fact, they were lured into a loan that was a subprime loan when they were really eligible for a more traditional loan and they are upside down? What are we going to tell them? What are all of us going to tell them in terms of how they are going to improve their FICO score?

Second scenario—and this will be a question to you to start off with and then to everyone else, because the second scenario is why I am particularly talking to you. I have a son who is about to be a junior in college, he goes to a great university, and is a smart kid. Literally last week, he sent me an e-mail, "Mom, I just found out that I have a FICO score of 600." And it was because when he opened up his checking account at a very prominent national bank they automatically gave him a credit card. He didn't know it was a credit card because kids mostly deal in debit cards. So he is using his debit card and, I guess, used this credit card in addition; and over the course of 3 months, he didn't pay in a timely manner and he now has a 600 FICO score.

What are we doing about all these young people who are lured into all kinds of products on the college campuses and who start out in life with lousy credit scores, because we are complicit in creating an environment where they exceed what they should be entering into?

So that is kind of a two-part question. I will start with you, Mr. Staten, and then I would like all of you to answer.

Mr. STATEN. Sure. I think we start by teaching them to pay their bills.

I am going to trade you another story. I taught a class in retail financial services at the University of Arizona this last semester. I asked all my students, as a matter of course, to pull their credit report.

I had one student who apparently didn't. At the end of the semester, he got a job, went to California, and was trying to look for an apartment. At that point, the landlord pulled the credit report and found that he has, despite having three bank cards, that by his admission that he has paid very well, he had a FICO score of about 560. Reason? He had collection activity that came from the Tucson Police Department because he had gotten several traffic violations that he had failed to pay—just ignored them, swept them under the rug.

I suspect that is not an uncommon thing that happens to young people.

It doesn't matter what the bill is, whether it is a credit card bill or a loan payment or a utility bill or a cable bill or a traffic ticket, young people have to understand that when they don't pay, there is a consequence; and that consequence comes forward in a lender's evaluation of their past payment history. Whether it is through their credit score or whether it is through pulling the credit report without the score, the lender is going to see that, to the extent that it is reflected in the credit report.

And I don't think young people fully appreciate how sloppy payment in the past has major implications for them, not just in getting credit and pricing credit, but in finding an apartment and doing other things.

It is a matter of education. We have to teach them that it matters, that it is important, that it can cost them; and then how to manage it.

Ms. SPEIER. And the answer to the first question?

Mr. STATEN. I have forgotten now what the first question was.

Ms. SPEIER. The 5 million Americans—

Mr. STATEN. I think you have raised another issue there in terms of the suggestion that some of them were duped into mortgages they couldn't afford. The fact is, now they are in a mess and they are stuck with a foreclosure on their record.

It will go away over time; we do know that after 7 years the thing drops off, and in fact more quickly than that, it has less impact on the credit score. How much impact it has is going to be a function of how much other credit they actually have, how much positive experience that they have been able to amass.

But that is about the best answer I can give you on that point.

Mr. ABRAHAMS. If I could go next, I would like to say that I think, from some of the statistics that I have heard, it takes them 11 years for, I think, a white non-Hispanic and maybe 14 years for an African-American borrower who has had to go through the foreclosure process before they can get on their feet again. So—there is a period of time before one has the capital to recover to approach homeownership, so it is a pretty severe problem.

The system that I am advocating would have determined from the get-go vulnerability that there was a product that would put at risk the affordability. And, secondly, just the concentrations, that the amount of concentration and the degree of concentration in certain borrower segments would be surfaced immediately, we are doing a lot of this product of people who are living paycheck-to-paycheck, have no savings, bought a home that was 3 times their annual salary, had 10 percent down. It is the perfect storm that you don't see when you are looking at all these things individually, but when you put them all together it paints a pretty compelling picture.

So I am not suggesting that CCAF would have prevented a subprime crisis. There are a lot of factors that went into that. But I do believe that a comprehensive approach would have been more helpful.

And as for the student, I was a student. I remember when I was at Stanford, I got my first Bank of America card back in 1974. And I was encouraged to get some credit, use it, let it revolve, don't pay it all off, let it revolve a little bit and then pay it and get established.

My point would be, if we have alternative data, if we could also track savings records—and we have to be creative about it, but other means of sourcing information outside of just credit usage, that one can be qualified, I think that would be helpful.

Mr. TURNER. In terms of your first question, we are actually in discussions right now with the Governor's office in the State of Ohio to analyze the efficacy of the Ohio Compact, which is an agreement between nine large lenders in Ohio, in the State of Ohio, about certain practices designed to effectively minimize the probability of moving folks from homeownership to foreclosure. And this model is being considered in other States. We want to operate in fact and know whether or not this is making a difference. So we would be happy to report those results.

I don't know what I would tell consumers who have been foreclosed or are facing foreclosure. But certainly, we would like to look at solutions and viable solutions.

That is what I will offer.

Mr. HENDRICKS. And I think, Congresswoman Speier, that where this committee can start is people have to know where they stand; and right now we are only halfway there in terms of seeing the actual scores on which they are judged and seeing the actual data that is in their subscriber version reports. We have to start there, because until you know where you stand, you don't know what you need to do next to get there.

But this goes back to our discussion with Congressman Barrett that we need a massive effort going into the communities to get people more financially literate on these issues because now it is not just interesting, it is crucial.

Chairman WATT. The gentlelady's time has expired.

I will just make one point as a reminder to the members who participated in the insurance scoring hearing that this is not unconnected, because once you get a 500 score on your FICO for credit purposes, you also have driven up your insurance rates because, remember, we were all troubled by that.

So this is not only credit, this is insurance. There is a transferability here.

The second point I would make, and I know you all want to, there is a big caucus that is getting ready to convene very shortly, the Democratic Caucus, so the members have to leave. It seems to me, with these 5 million people, Representative Speier, we may end up having to grade on the curve at some point. Otherwise, I don't know how you are going to go forward extending credit to people who, but for having gotten into these kind of mortgages that they really couldn't afford, would have reasonably good credit.

So, anyway, I didn't get a chance to ask questions. I am concerned—well, I am going to stay long enough to ask my questions, but you all feel free to leave, which is why I decided to go last, because I knew you all had given at the office today, beyond the call of commitment, and I definitely appreciate it.

Mr. Abrahams, the concern I have about your approach—and I want you to convince me that I am wrong about it—is that it seems to inject more subjectivity into it. There will be a category of people for whom your approach would be a lot fairer, but I think there would be some concern about the level of subjectivity that is injected into the process.

And that would be a concern that I think Representative Cleaver would have. So if you can address that quickly, that would be helpful, I think, to him and to me.

Mr. ABRAHAMS. Thank you, Chairman Watt.

What we are advocating is not going back to the old method of every loan officer is a system. We are talking about systematic policy application, proven principles that are understandable, that are the basis for how people would want to responsibly handle their financial affairs.

I am talking absolutely connected to, that we didn't reinvent the wheel of the five "C's" of credit. And the character part deals more with just your payment history, which are capacity and your capital. And so the idea is that this would not be anything like pulling out of the air; it would be proven and it would be accepted and it would be well-documented and consistently applied. It would be more consistent than credit scoring because credit scoring today

has overrides after the fact, anywhere from 5 to 10 percent overrides on the low side and sometimes 10 to 15 percent on the high side. So we say we have this great score but then other things come into play.

I don't dispute that those are not correct decisions, but this method brings all that together in one at the same time and renders a decision without first creating a score. It first classifies, then risk rates; it doesn't risk rate and then classifies. So I think we have that a little bit turned around in the way we are doing things today.

I hope that is helpful. But the idea is that the judgment is systematically applied. And it is not an individual's judgment; this would be a corporate judgment.

Chairman WATT. I think I am going to withhold the rest of my questions, and just submit them in writing.

Let me, while I have somebody here who could object if they chose to, ask unanimous consent to submit for the record the Federal Reserve's response to a list of questions that we asked them to address, that we thought we would have at the beginning of the hearing. It hadn't gotten here, but it came during the course of the hearing today.

And the Federal Reserve also released a report in August of 2007 that was required under section 215 of the FACT Act. I ask unanimous consent to submit that for the record.

[The Federal Reserve report can be accessed at http://federalreserve.gov/boarddocs/rptcongress/creditscore/default.htm]

And I also ask unanimous consent to submit for the record the Consumer Federation survey that I referred to in my opening statement. I am just trying to get a full record here so that anybody who wants to go and really, really delve into this subject will have the information they need to do it.

It has been wonderful. I am sorry that we backed you into a timeframe where we couldn't explore as extensively with you as we did with the first panel. I can tell you that one of the questions I am going to want you all to be addressing in writing is whether the credit reporting agencies can, consistent with the FACT Act obligation, which requires complete and accurate consumer reports, base their numbers on maximum available credit as opposed to credit that is actually outstanding. It would be interesting to get your reaction to that. That was one of the questions that I asked in the earlier panel and didn't seem to get as forthcoming an answer as I thought I might.

We thank the members for being here, and this is an extremely important subject. We hope that people have flocked to their televisions to watch C-SPAN 3. And if they did, that they learned a lot about credit scores, credit reports, alternative data, and the pitfalls that are out there. I would tell them that it is not only out there for credit decisions; it is out there for insurance decisions, too, because of the way this thing is structured now.

So, with that, I will note that the members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

And with that, thank you all for being here. The hearing is adjourned.

[Whereupon, at 5:15 p.m., the hearing was adjourned.]

# A P P E N D I X

July 29, 2008

"What Borrowers Need to Know About Credit Scoring Models and Credit Scores"

Testimony of Clark Abrahams, Chief Financial Architect, SAS Institute, Inc.
Before the House Financial Services Committee, Subcommittee on Oversight and Investigation

July 29, 2008

Chairman Watt, Ranking Member Miller, and other distinguished Members of the Subcommittee, I am Clark Abrahams, Chief Financial Architect at SAS, a leading provider of business intelligence and analytical software, based in North Carolina. SAS has more than a quarter century of experience providing decision-based support to the financial services sector.[1] In terms of my own personal background, I have twenty-five years in the credit assessment and banking business, and another ten years in consulting and software development. On the technical side, I have developed, or directed the development of, thousands of credit models in my career.[2] On the business side, I have served on corporate and board-level loan committees, developed and enforced credit policies, and dealt with customer and shareholder concerns. I have personally conducted corporate loan policy assessments for consumer and commercial lending under regulatory supervision, managed the liquidation of bank assets comprised of defaulted loan collateral and have had to deal with disposal of assets associated with all aspects of defaulted

[1] With more than 30 years of experience in financial services, SAS works closely with top financial institutions to provide timely solutions that address critical business needs. In the financial services industry, SAS data integration, fraud detection, risk management, regulatory compliance, Customer Relationship Management and other software is used by more than 3,000 financial institutions worldwide, representing 97 percent of banks in the Fortune Global 500. SAS' industry expertise is evidenced by long-term relationships with large and medium-sized banks and financial institutions. Furthermore, financial services is SAS' largest industry segment by revenue, contributing 42 percent of the total company worldwide revenues of $2.15 billion in 2007.

[2] These include: 1) credit scoring systems for secured and unsecured lending, 2) credit validation and monitoring systems for assessing underwriting performance, 3) scorecard adaptability assessments, 4) consumer credit auditing models used to assess of judgmental model decisions and loan grading, 5) post-scoring judgmental extensions to credit bureau scores and custom application credit scores to increase automatic approvals 6) behavioral and econometric credit loss and loan pre-payment forecasting, 7) commercial loan grading and default estimation, 8) loan portfolio sub-prime concentration risk to capital, 9) valuation of credit card portfolios for sale, 10) construction and quality assessment of credit card securitizations, 11) fair lending disparate treatments testing for mortgage loans and override analysis for credit scored HMDA-reportable loans, 12) fair pricing analysis and overage/underage statistical testing for mortgages.

loans, including foreclosure proceedings. In my current position at SAS, I have conducted research and helped to pioneer new software solutions in the areas of credit granting and fair and responsible lending assessment. The breadth of my experience has afforded me a multi-faceted perspective of the issues currently discussed by Congress, and being felt by the nation. Based on all of my experiences, I believe there are opportunities for improving credit risk measurement, with the added benefits of more accurate assessment of fair and responsible lending, and advancing financial literacy of consumers.

I very much appreciate the opportunity to testify before you today on the important issue of credit scoring and fostering better understanding of the credit modeling process and the interpretation of credit scores. Credit markets are influenced by what information is made available and also by tools that are used to manage and analyze that set of available information. Therefore, I want to acknowledge the contributions made to affording the ready access to historical credit information provided by Experian, TransUnion, and Equifax and the pioneering work by Fair, Isaac, and Company. Over the years I have been privileged to work with all of them. Their efforts have unquestionably resulted in far greater access to credit for many consumer segments. As with any new idea, in order to make the case for a change I must necessarily point to areas where improvements can be made. I believe that the road to improving the current credit system is paved with greater information, illuminated by innovation, and built through collaboration.

My objective for testifying today is to discuss how the credit scoring process can be enhanced to help consumers, financial institutions, and regulators better measure and understand risk. The current system has met many needs and continues to be appropriate in many situations.

Like most things, however, our current system can be improved to provide both a more effective measurement and a better understanding of borrower risk, loan portfolio risk, and credit concentration risk at the enterprise, regional, industry, and national levels. This will be critically important to regain and maintain financial stability going forward. David Nason, Assistant Treasury Secretary for Financial Institutions recently said that the industry has "to be able to segment a population in a way that can create long-term solutions." I wholeheartedly agree with Assistant Secretary Nason, and have devoted a great deal of energy to create some applicable segmentation examples and a computer-based methodology that can leverage any segmentation scheme to measure, monitor, and control credit risk for the lender, while thoroughly identifying for consumers how they rate overall, and also relative to the primary loan qualification factors.

Over the past five years I have been conducting research on this subject and developing software solutions for the marketplace at SAS. My initial focus was actually on fair lending statistical analysis, including development of a singular measure that captures all fair lending risk,[3] a systematic approach for fair loan pricing analysis, and an enhanced regression model that more effectively captures how lending policies are applied to loan approval and pricing decisions, resulting in better predictive power and a reduced chance that patterns of potential disparate treatment will remain undetected. As a by-product of this research, it became clear that if the credit underwriting system could segment borrowers into homogeneous risk groups relative to their credit qualifications, and the givens of the loan transaction; and if that system could also decision the loan applicant and price the risk of the loan according to that segmentation scheme, then the fair lending analysis would be considerably simplified. A Comprehensive Credit Assessment Framework (CCAF) accomplishes this objective, because it groups similarly situated borrowers

[3] based on HMDA, US Census Bureau, and credit underwriting data

relative to primary factors in the loan underwriting process, better ensuring that all loan applicants are evaluated fairly and consistently. As a result, all fair lending disparity indices, including decline and above-trigger pricing should be close to parity within each of CCAF's borrower segments.

Underwriting Gap

Today there is an underwriting gap in credit evaluation and loan underwriting practices, and a more comprehensive approach is needed. The underwriting gap refers to the difference between the underwriting decision model and the borrower, the business and market realities. The realities I refer to encompass how well the loan approval and pricing process meshes with: 1) borrower objectives (such as home ownership), their true credit qualifications and the sacrifices they are willing to make to attain their objectives, 2) the lender's business objectives, risk tolerance and policies, and 3) the ever changing levels of market prices, interest rates, loan demand, and liquidity. Narrowing this gap will result in more accurate loss and default predictions, fairer treatment of the customer and less reliance on pure scientific models and their attendant assumptions. We must view borrower's answers to the most relevant credit qualification questions simultaneously in order to evaluate the credit risk and to know what type of credit is affordable, and most appropriate for their needs. The benefits of putting borrowers and their credit transactions in the proper context before attempting to determine creditworthiness, or how much to charge for a particular loan, will be invaluable in understanding the overall risk. A Comprehensive Credit Assessment Framework combines the best of judgment and science to create a holistic picture of borrower risk.

There are several modeling components that can be leveraged to close the gap, namely a data component, a sampling/segmentation component, a model factor component, a model formulation/construction component and a model deployment/operational component. These areas are described in greater detail in a CCAF white paper that we have included with this testimony. In a nutshell, underwriting gap components can be addressed by 1) improvements in methodology, such as requiring that known causal factors are included as opposed to letting the data determine what is included based upon pure statistical correlations in the sample, 2) inclusion of a broader set of information that is input to the models, such as alternative data and insurance, 3) inclusion of more observations that might otherwise be excluded due to missing data and indeterminate loan performance 4) less reliance on assumptions, such as "the past determines the future" or the degree to which non-mainstream consumers seeking credit resemble their mainstream counterparts relative to scorecard factors, and 5) more effective model deployment/operation to continually gather and incorporate information to improve decisions over time, and to eliminate any override processes, which can lead to inconsistency in treatment. Relative to the last point, unlike credit scoring, the system becomes less reliant on the original data sample as time progresses and any changes in borrower qualification rules or ratings are handled within CCAF, not "after-the-fact."

Historical Context for Credit Scoring

A good way to understand the credit environment of today is to understand where we started. Over time, there has been a transition from a more "judgment-based" credit granting system (as the phrase is used in Regulation B, Section 202.2(t)), to what we have today, which is primarily a science-based system.[4] Before the 1960's, consumer loans were made using loan officer experience, with some guiding principles. Common practice was to consider the "5C's of credit", namely Character, Capacity, Capital, Collateral, and Conditions when evaluating a consumer loan request.[5] This approach looked at the ability of the borrower to repay the loan through income (Capacity) and, in the event of any interruption in income, their savings or liquid assets (Capital). It also considered the borrower's character by evaluating indicators of stability, his/her performance in meeting current and past credit obligations, and the liquidation value of any collateral and the borrower's equity share in cases where the loan collateral was the property being financed, e.g. real estate, automobile, boat, etc. Finally, conditions were considered that related to the general economic climate and the terms of the loan agreement, such as loan amount, interest and fees, and repayment schedule. This represented a comprehensive approach that had been validated over a long period of time.

The "judgmental" approach, as then practiced, was not without its shortcomings.[6] Because each loan officer constituted "a system," resulting loan decisions were sometimes inconsistent. The breadth and depth of experience varied by loan officer, and there was always the potential for bias in individual decisions. Indeed, there is anecdotal evidence that some occupational biases

[4] Regulation B Section 202.2 (t) describes a "judgmental system" of credit evaluation: "Judgmental system of evaluating applicants means any system for evaluating the creditworthiness of an applicant other than an empirically derived, demonstrably and statistically sound, credit scoring system."
[5] For examples of the 5C's see Abrahams & Zhang (2008) pp.185-186
[6] For a list, see Abrahams & Zhang (2008) pp.187

existed by virtue of the 3B's: "Never lend to beauticians, bartenders, or barbers," or the 3P's, "Never lend to preachers, plumbers, or prostitutes."[7]

Credit scoring offered a more objective approach, providing consistency, speed, and quantification of the risk that a borrower might default on the loan. Furthermore, scoring was believed to be more accurate because no one loan officer could possibly have all of the relevant information about the total lending pool to make legitimate predications about which ones were good, and which loans would go bad. It was further asserted that even if the loan officer was given access to the information, he/she would be incapable of taking into account the multitude of factors that might come into play in scorecard development, nor could he/she account for all of the correlations among the variables and causally link the result to loan default outcomes. Scoring models can make large quantitative assessments not possible by humans. With scorecards, you could standardize the criteria by which loans are granted, which made comparisons between borrowers facially more objective. This was invariably felt to demonstrate the superior predictive ability of the scoring model over any particular loan officer's judgment-based decision.

The increase in accuracy was actually attributable to a combination of several factors, including the type of modeling approach, the technological means to create the model, and the available data. In reality, the comparison was between a judgmental model, developed by a human being and based on a limited set of loans, versus a statistical model, developed on a computer and based on all of the loans made by all of the loan officers. Our new approach combines the strengths of the two modeling approaches using a computer and it possesses the ability to include an even greater number of observations while incorporating alternative data, insurance data, and

[7] Ibid, p.187, Figure 6.3, note (a)

other information that is pertinent to the lending decision. Instead of a scorecard that has fixed factors and fixed point values, our approach consists of an action table comprised of segments that can have actions based on a combination of factors, which can vary by table entry, with different weights. Furthermore, each segment, or table entry, can access predictive models and utilize business rules that can represent any conceivable credit policy before quantifying the risk and rendering a decision. Due to its flexibility and degree of sophistication, the system can provide thorough and concise supporting reasons for any loan decision, per Regulation B.

Early-on, scorecard developers found that correlations made it unnecessary to consider more than 7-10 factors and it was determined that the presence or absence of particular factors having perhaps a more explanatory relationship with loan default was irrelevant. In the 1970's applicant income was eliminated from most scorecards because it was inflation-bound so that specific income ranges would quickly become out of date, thus requiring the scorecard to lose effectiveness. Scorecard developers found that dropping income from the scorecard did not have significant impact because of the fact that it was highly correlated with other factors they could include. It was also reasoned, and empirically verified, that wealthy people do not pay their bills on time and hence scorecard bad loan development samples included delinquent borrowers possessing strong capital, irrespective of whether or not they actually ever defaulted on a loan. As a direct result of the inclusion of delinquent payers in the sample with defaulters, the finding that wealth is not predictive has to fall in the self-fulfilling category rather than be categorized as a surprising result. We assert that if non-defaulters are excluded from the bad loan sample, then factors that measure borrower capital and capacity will reflect higher information values.

There is no dispute that credit scoring models work. They do a great job of what they set out to do, namely classifying historical samples of credit applicants with known performance into good and bad groups. However, if we step back a bit and broaden the object of the exercise to revisit the basic question of "Who is creditworthy and who is not?" then we must ask ourselves the question "Based on what?" So far, the resounding answer has been "Whatever is in your credit file," and also "Whatever is not in your credit file." So, we must ask ourselves if creditworthiness should depend on how often we seek credit. Why should seeking credit (i.e. number of credit inquiries) cause greater risk? A model may indicate so. The problem is that with any observed phenomenon there are always plenty of supporting theories that can be posed. But theories are theories, and when we are trying to convince ourselves that a model is correct, then theory can become all too compelling. If consumers make other choices, such as not using installment credit to finance purchase of cars or major appliances, does that, or should that, affect their credit standing? Suppose they do use installment credit, but if they do not respond to credit card offers that fill their mailbox so that the ratio of their revolving to installment credit is within an expected range of, say, six to one, does that mean they are any less creditworthy?[8] An obvious question for consumers is how can they know what impact any particular choice they make will have, e.g. to open, or not open, or close, or not close a credit account, or apply for a loan, or moving their residence, or changing jobs, and so on.[9] The point is that an individual's credit worthiness should depend upon their ability and willingness to repay an obligation. Suppose consumers could know

[8] I have heard it rationalized that consumers who do have a lower revolving to installment ratio are people who do not get a lot of offers in the first place. The fact that they are not on the pre-screen mailing lists may be viewed as a signal that they do not meet the pre-screening criteria and therefore are probably higher risks.

[9] Common practice is to penalize mortgage applicants if they have been less than 24 months on their job. This is another example of a case where, despite data that indicates the longer someone is at their job, the lower their credit risk. It makes intuitive sense. The problem is that other relevant facts are missing, such as the circumstances of the job move. Was it to take a better job for more money, versus a layoff? Are we saying the people who get promoted are higher risk because they are grouped in with their statistical counterparts? Variables in a model may lack valuable context.

exactly how points are assigned to come up with their credit score. Are we to tell consumers that being responsible in their financial affairs means that they need to modify their behavior so as to maximize their credit score?

In the beginning, we had guiding principles in lending that related creditworthiness directly to the borrower's ability to repay the loan. Then science came along, and we determined that our models could find suitable substitutes for common sense. The CCAF approach seeks to revisit that fork in the road, and retain the guiding principles, while incorporating comprehensive information, including alternative data, and the best that science has to offer.

The Comprehensive Credit Assessment Framework, CCAF

The basic idea of CCAF is to first ensure a comprehensive view of the lending decision with respect to the broadest primary factors that are pertinent to any credit granting. For that exercise, we did not have to "reinvent the wheel" known as the five C's of credit, namely character, capacity, capital, collateral, and conditions. Each of the primary factors are comprised of several rating categories that are generically termed, such as strong, moderate, weak, or poor. A loan applicant is rated according to objective criteria, for example for capacity the borrower's debt ratio and other factors would be taken into account. The character, capacity, and capital factors relate to the borrower, while the collateral and conditions factors relate to the specifics of the loan transaction. Once the borrower is classified by the primary factors, they are assigned a segment number and that number can easily be deciphered to reveal exactly where they stand relative to primary qualifications. Depending upon the borrower's primary givens, secondary

factors or policy rules may be brought into play to render a final decision. Just like credit scoring models, CCAF is validated to ensure model accuracy is achieved and maintained. Moreover, because CCAF's primary elements are explanatory in nature, a deeper qualitative validation is possible and performed, and because it is adaptive in nature, it becomes more predictive over time and does not need to be replaced at regular intervals.

A system that integrates the best from sound credit principles *and* statistical modeling is ideal for today's credit environment for several reasons. It creates a better, more complete and comprehensive view of risk for borrowers, lenders, and regulators because it includes more data, and it guards against over-reliance on pure statistical correlations or incomplete models and data. An integrated approach can also allow for a flexible, robust system that can accurately evaluate the risk of borrowers, regardless of the depth of their credit history, providing them the appropriate access to credit at appropriate rates. Most important, an integrated approach affords better control of the models and can provide more stringent qualitative and quantitative-based safeguards for the credit granting process. Existing credit scoring models can be incorporated in this framework, and indeed a scoring approach to rate borrowers by the primary factors used to categorize credit applicants may result in far more credit scoring models than are in use today. In any particular implementation, the degree to which scoring is used will depend upon what the data indicates, and other considerations.

CCAF represents a comprehensive and integrated approach for credit granting. More information used in an effective manner can improve credit risk management and increase transparency. Credit granting is a multi-dimensional problem, and it demands a multi-dimensional

solution. When structural changes occur in the incoming loan applicant population relative to several primary credit factors, CCAF can provide deep understanding of the root causes. Acceptance rates and loan originations can be tracked relative to any factor, or combination of factors. Positive and negative variances relative to originations, declines, and loan defaults can be effectively examined and better understood. CCAF represents a common sense approach to understanding borrower-level credit risk that can also help foster understanding of institutional credit risk when viewed in the aggregate.

CCAF also is flexible in its loan approval process because loan applicants that require further action based on their primary classification are evaluated based on their segment, and not the general population. That means that the secondary factors appropriate for one set of borrowers is not necessarily sufficient for others. Furthermore, even if the secondary factors are identical for different segments of borrowers, they can have completely different weights. Moreover, CCAF is not restricted to variables and formulas – it can also use business rules in the loan decisioning process. In this way the system can be updated by changing rating thresholds, by modifying secondary factor thresholds, by introducing or eliminating secondary factors, and by modifying or adding business rules at the consumer segment level. The longer the system is in place the more it can evolve to meet important credit qualification considerations for borrowers. Credit scoring models do not possess this flexibility, as the factors are fixed and the factor weights are also fixed. However, credit scoring models can be applied at the segment level to address combinations of segments that require additional risk evaluation. In this way, CCAF not only enforces credit policy – it can help shape it as results are compiled. Hence, CCAF constitutes both a risk evaluation and a policy formulation system.

Strengths of the CCAF

As just described, the CCAF differs from traditional credit scoring in that it categorizes borrowers according to all primary underwriting factors. These factors generally are derived from key risk indicators, such as debt ratio and loan to value ratio, and are also derived from business rules that examine multiple items that measure such things as capital strength and liquidity. The resulting categorization provides a single number (transaction contour identifier) which immediately provides a picture of the strengths and weaknesses of the borrower relative to the primary qualification criteria. Then, a rating scale is used to describe the overall credit rating when all relevant factors are combined. The scale is based on the observed performance in each borrower categorization. The importance of categorizing borrowers before attempting to risk rate them on pieces of the framework, such as payment history, is that the resulting odds quote is then implicitly based on an "average" over all other factor groups not considered, and so it represents a probability of default, or score, that is "out of context." The result is either an understatement, or overstatement, of the true credit risk, which is bad both for the lender who is trying to price the risk and help the consumer select an affordable loan, and also to the consumer who may either end up over-charged or approved for a loan that could put them at risk of default.

The power of the CCAF is in its ability to look at the 5 C's of credit in context with one another, a method that is not currently used with credit scoring. One must understand a borrower's current financial position and, especially for mortgages, future market conditions to understand his or her comprehensive risk profile. Consider the simple case where we define strong, moderate,

and low capacity based on a ratings associated with a financial obligation ratio and borrower savings ratio, defined as their monthly savings amount divided by their monthly income. The savings ratio categories in this hypothetical example are none, low (less than 3%), moderate (3-7%), and high (8% or more). Suppose we are dealing only with credit payments so we use a debt ratio that we categorize as low (for values under 30%), moderate (for values 31-45%), and high (for values greater than 46%).

| Case | Debt Ratio | Savings Rate | Capacity Rating |
|---|---|---|---|
| 1 | **L** | **None** | Moderate |
| 2 | **L** | **Low** | Strong |
| 3 | **L** | **Mod** | Strong |
| 4 | **L** | **High** | Strong |
| 5 | **M** | **None** | Low |
| 6 | **M** | **Low** | Moderate |
| 7 | **M** | **Mod** | Moderate |
| 8 | **M** | **High** | Strong |
| 9 | **H** | **None** | Low |
| 10 | **H** | **Low** | Low |
| 11 | **H** | **Mod** | Low |
| 12 | **H** | **High** | Moderate |

Figure 1.Capacity Rating

If a consumer had a debt ratio of 34% and had a savings rate of 6%, he/she would be classified in case 7 and would be rated as a moderate capacity risk, as shown in figure 1 above. From a consumer literacy standpoint, this type of model would not only encourage savings, but would provide useful information to consumers on how the rate of savings can impact their classification.

Similarly for capital, suppose we were to simply adopt the ratio of liquid assets divided by after-tax monthly income, ignoring savings. Suppose we define the rating categories for capital as

follows: Low (less than 3 months), Moderate (4-6 months), Strong (7-23 months), and Excellent (24 months or more). If a consumer had $15,000 in liquid assets and an after-tax monthly income of $3,000, then the months of reserves would be 5 and they would fall into the moderate capital category.

The following hypothetical examples contrast how a couple of different consumers would be evaluated based on a bureau credit score versus CCAF based on just the first 3 C's of Credit.

Example #1: Let's take a borrower who is a well-established revolving credit user primarily for the rewards benefit, pays his credit off monthly, and possesses very strong capacity and ample liquid capital reserves. This consumer pays cash rather than installment credit to purchase automobiles and home appliances, which will lower his credit score. The CCAF would categorize this person and rate them based on their strong capacity and liquid capital. Lack of installment debt would be irrelevant to CCAF. If alternative data were included with full file positive information, the outcome would be surely be a loan, and accompanying rate that is commensurate with the total risk picture of the borrower.

Aside from the issue raised by this borrower, there are other issues. For example, some borrowers in a better financial position, generally speaking, may risk delinquency in their credit payments because the late fees that might be charged are not viewed as a deterrent. The delinquencies could also lead to a lower credit score under traditional credit scoring methodologies despite the borrower's capacity to repay. Because the lowered credit score may over-penalize the borrower, with credit score-driven risk-based pricing, this consumer may pay more for their

financing than is necessary or reasonable given their total risk picture. Also, borrowers who experience hardship, but eventually pay their debts, have to suffer for two years or more with a blemished credit history when that history may represent no additional risk to a creditor. The CCAF would treat such a borrower quite differently. A borrower in a strong financial position would be viewed not solely on their delinquencies in isolation, but on their *overall* financial position, taking into consideration their income (capacity) or their capital (savings). This borrower's delinquency patterns do not pose the same risk when other factors are considered to put the facts in their proper context. With CCAF, the consumer would experience a quicker improvement in his/her credit standing based on current information.

Example #2: Let's take a borrower with a small amount of capital and a relatively small, but steady, income over several years, with very little existing debt. In this instance, his or her payment history of meeting obligations must play a greater role. Under traditional scoring models, this borrower may not obtain a loan, or may have to pay a high interest rate. This conclusion is consistent with the Federal Reserve Board's recent report to Congress on credit scoring, which noted that recent immigrants and young people were assigned lower scores by the models they developed than is appropriate, given the actual performance of these groups.[10] CCAF, on the other hand, would evaluate this borrower more holistically, so that the lack of credit usage would be given less weight.

For loans secured by real property or financial assets (like a mortgage, where the house is the collateral), the 4th C of Credit comes into play. For purposes of simple illustration, we can

[10] "Report to Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit," Board of Governors of the Federal Reserve System, August 2007, p.117

adopt loan-to-value as a measure for collateral (in practice physical properties, appraisal, and other information come into play). Suppose we assign a rating of high (over 90%), moderate (70-90%), and low (less than 70%).

Furthermore, we can examine the 5th C of Credit and we may rate conditions as a measure of borrower vulnerability to changes in economic conditions. CCAF takes into account future possible scenarios that impact capacity relative to changes in payment amount due to rising interest rates, capital relative to principal pay down of the loan that increases equity position in the property, and collateral relative to prevailing housing market conditions.[11] Borrower vulnerability will alert the lender immediately if the consumer is applying for a type of loan product that is not suitable due to future affordability risk, even if that product provides a smaller payment amount in the short run, which in turn improves borrower capacity. Current credit scoring models could possibly incorporate this type of factor, presenting this as an opportunity to use scoring technology to quantify borrower vulnerability.

Alternative Data-A Critical Component

The purpose of the Equal Credit Opportunity Act, or Regulation B, was to promote the availability of credit to all creditworthy applicants without regard to race, color, religion, national

[11] Two candidate metrics combine to capture this risk in three rating categories – high, moderate, or low. First is future LTV, defined as the ratio of the remaining principal amount to the quantity equal to the current market value of the property minus the standard deviation of the value of the property over the past 5 years. The second metric is a future to current payment ratio. The numerator is equal to a probability-weighted payment amount based on the current payment amount at loan origination, the maximum possible payment amount 5 years into the contract, and the simple average of the two payment amounts; the denominator is the loan payment amount at origination. A business rule rates vulnerability as high, moderate, or low, based upon whether the new payment will exceed the policy debt ration and whether the future LTV exceeds a threshold, e.g. 100%. This takes into account both 1) the impact of a housing bubble which can lower the value of the home and curtail access to capital via cash-out refinancing and 2) the risk of rising interest rates which can dramatically increase loan payments

origin, sex, marital status or age.[12] In principle, borrowers should be able access credit at a risk-appropriate price, regardless of the extent of their credit history, provided they have a track record of acceptable payment on their regular payment obligations. Bill payment history can be substituted in cases where there is a lack of credit history, or it may be used to create a bill payment history that integrates both sets of information. There are important indicators that can be derived from these data, similar to what is being done successfully by the credit bureaus today for credit data. Most often these data are either unavailable or they are not sourced for inclusion in the loan underwriting process. Examples of alternative data include bill payment data for rent, utilities such as electricity, gas, cable, water, telecommunications, insurance, and so on. Additional examples include deposit-related data that covers savings deposit frequency and amounts, checking and savings account duration and balances, frequency of checks with insufficient funds, and so on. Empirical studies conducted on this type of data have demonstrated that they have predictive value. As such, they could help make credit more accessible to consumers who are presently not in the financial system mainstream, or for those who greatly limit their use of credit, but are nonetheless capable of repaying a loan. Alternative data is now more often being considered by lenders but has not yet become mainstream.

In many instances in today's credit system, consumers are rewarded for being more highly leveraged (i.e. having more debt), and penalized for paying with cash. For example if a consumer having no installment debt has $15,000 of capital and uses most of it to purchase a car and a major appliance, his/her capital position is lowered, but his capacity is unchanged, and his credit bureau score is unaffected. Consider case 2, where the consumer finances the car and major appliance with installment contracts, his/her capital position is unaffected, capacity is lowered due to a

[12] Regulation B Section 202.1, Authority, Scope and Purpose

higher debt ratio, and his credit bureau score will improve, all else being equal. Clearly there is more credit risk and cost to the consumer in the second case, but the credit score is focused on credit usage, and mix of credit, and it sees a lower credit default risk.

The information value contained in alternative data and community data[13] has made it increasingly apparent that significant ground can, and must, be gained in enhancing the state-of-the-art in consumer and small business lending relative to those segments in particular, and perhaps for all borrowers in general.[14] A recent study by the Brookings Institution Urban Markets Initiative and the Political and Economic Research Council (PERC)[15] found that those outside the credit mainstream have similar risk profiles as those in the mainstream when including nontraditional data in credit assessments. The report also found that using nontraditional data decreases credit risk and increases access to credit for those who are creditworthy.

With greater information, lending decisions become better, with lower rates of delinquencies, less overextension, and an increase in the number of performing loans. This will shore up data gaps in the credit evaluation process, especially relative to payment history for non-credit obligations and borrower capacity.

Alternative data can be readily fed into CCAF's handle structure for the purse of segmentation and modeling. Without changing any model factors for payment history, one can incorporate non-credit trade lines. Consider the following example.

[13] See www.socialcompact.org for more information.
[14]See Turner, Michael, S. Alyssa Lee, Ann Schnare, Robin Varghese, and Patrick D. Walker. "Give Credit Where Credit Is Due —Increasing Access to Affordable Mainstream Credit Using Alternative Data," Political and Economic Research Council and The Brookings Institution Urban Markets Initiative, ©2006. available: http://www.brookings.edu/reports/2006/12communitydevelopment_turner.aspx
[15] Ibid.

Suppose the payment history dimension of CCAF consists of three ratings, Good, Fair, and Poor. Further suppose that this rating is based on three factors, namely whether or not the consumer has defaulted on an obligation in the past 5 years, whether they are new (credit file less than 2 years old) or established, and their delinquency record, characterized as mild, moderate, and severe[16]. With this information, one can rate borrower payment history based on the scheme shown in Figure 2 below:

| Case | Non-Payment | History | Late Payment | Rating |
|---|---|---|---|---|
| 1 | **Defaulter** | **New** | **Mild** | High |
| 2 | **Defaulter** | **New** | **Moderate** | High |
| 3 | **Defaulter** | **New** | **Severe** | High |
| 4 | **Defaulter** | **Established** | **Mild** | Medium |
| 5 | **Defaulter** | **Established** | **Moderate** | High |
| 6 | **Defaulter** | **Established** | **Severe** | High |
| 7 | **Non-Defaulter** | **New** | **Mild** | Low |
| 8 | **Non-Defaulter** | **New** | **Moderate** | Medium |
| 9 | **Non-Defaulter** | **New** | **Severe** | High |
| 10 | **Non-Defaulter** | **Established** | **Mild** | Low |
| 11 | **Non-Defaulter** | **Established** | **Moderate** | Low |
| 12 | **Non-Defaulter** | **Established** | **Severe** | Medium |

Figure 2. Borrower Rating for Payment History

The point here is that even delinquent patterns need to be put within the context of whether the consumer is a defaulter and how long they have been paying their bills. The identical definitions can be used to characterize alternative payment data if we simply modify the definition of defaulter to be service discontinued with a balance, apartment vacated with rent due, etc. In this case a

[16] In this example mild delinquency would include no delinquency.

lender using CCAF would require simply the segment number (from 1 to 12) for the consumer. It is possible that the typical credit score would be retained for comparative purposes.

As mentioned earlier in my testimony, challenges exist in obtaining alternative data. For example, many public utility companies are concerned with the liability of reporting the information reliably and accurately to the credit bureaus. There are companies like Payment Reporting Builds Credit, where my colleague Michael Nathans is currently able to effectively create a credit history for individuals without a traditional credit history (mortgage, student loans, credit cards) by putting together non-credit payment data[17]. Many people with a little or no credit history can end up with a more representative credit score, and thereafter access to credit and a lower interest rate when this type of information is compiled.

Benefits of CCAF: Transparency, Accessibility, Comprehensibility

Greater transparency for the consumer will enable them to understand how they are rated in primary qualification areas and will provide them with specific thresholds that they need to achieve in order to strengthen their credit standing. This puts control into the hands of the consumer while fostering "good" habits. One issue with a statistical model is the concern that, if divulged, consumers will try to "game the system." On the other hand, depending on the factors in the scorecard, the factors might indicate that the consumer needs to borrow more, or borrow

[17] Example from Brookings Roundtable on Use of Alternative Data in Credit Scoring, December 2005, presentation by Michael Nathans,PRBC,:Consumer had a FICO Score of 568 and a PRBC Bill Payment Score of 781; Medical issue over 3 years ago caused financial hardship; No late payments in past 36 months; Some slow payments 29+ month s ago; On a $225,000 mortgage the difference in APR is 2.5% based on the score differential; The financial dollar impact by score differential is $5,600/yr or $468/mo in the mortgage payment Since that time, In November 2007, PRBC partnered with Fair Isaac to deliver more comprehensive capabilities with the Fair Isaac Expansion score, which incorporates alternative data.

differently, or follow some pattern that is not in sync with the consumer's particular lifestyle, culture, normal habits, or desire. We should have a credit granting system that encourages safe and sound practices – why encourage people to borrow just so they can create a payment record for credit qualification? Its primary focus must be on the financial position of the borrower, the borrower's history of meeting payment obligations, the borrower's equity stake in collateral secured by the loan, and the borrower's vulnerability to increases in market interest rates and softening of economic sectors that impact collateral values. We envision that the consumer would have access to their segment identifier and their factor ratings, perhaps on their monthly statement, so that they can examine it, verify it, and observe how it changes based on the financial choices they make and as their circumstances change.

CCAF can also deal more effectively with missing data than credit scoring. In many cases, the data may not be required due to the primary factor categorization. CCAF is deployed in two stages. Stage 1 consists of primary factors. Stage two consists of secondary factors and business rules. Depending upon the segment, any particular data items may or may not be required. Observations that are missing data for factors not pertinent to the particular segment in which the record falls can be included with zero impact on the model. If the data is required, CCAF has the capability to apply business rules to compensate in the most appropriate manner.

The CCAF provides consumers with the ability to see their risk picture and the attributes that make up that picture. With an understanding of the attributes, the borrower is empowered to take the steps he or she needs to, to change or improve that picture. It thus fosters financial literacy and it represents a very transparent process for the consumer. Loan portfolio managers,

loan pool securitizers, regulators, economists, policy makers and fair lending compliance officers can all benefit from greater transparency that the CCAF segmentation can provide when aggregated appropriately. Limits can be set to regulate segment concentrations per corporate or secondary market requirements. If industry standards are adopted, then CCAF could provide important new benchmarks and early warning on consumer and portfolio trends. For example, if at a national level we see a perfect storm brewing whereby the borrower segment representing low capital, low capacity, high loan to value, and high vulnerability, then we would not have to wait for the normal early warning barometer, namely delinquencies, to start flashing. Going forward, CCAF would provide lenders and regulators with a multi-dimensional capability to spot concentration risk while it is building, so that risk can be limited. From a loss mitigation standpoint, CCAF may be of use to systematically segment loans that either are, or will be, in trouble and assign them to appropriate workout strategies.

Conclusion

For the benefit of borrowers, institutions, and regulators, as well as the overall economic well-being, a fresh perspective on measuring risk is needed. The approach I have described in this testimony will ultimately prove to afford superior accuracy as data and borrower performance accumulate over time. It will also provide greater transparency for all stakeholders in that it will enable consumers to easily see a broader and more direct impact of their financial choices and habits on their credit standing. The flexibility of this approach will enable the consumer's creditworthiness to be viewed in a deeper and more complete context. As a result, the final loan

decision will have incorporated and weighed only those secondary factors that are relevant for the loan in question.

A comprehensive framework that combines the best that judgment and science have to offer, can greatly enhance existing credit scoring models and underwriting processes, and ensure fair access to credit by promoting transparency and common-sense.

I appreciate the opportunity to be here today to present views on enhancements to the credit system I welcome the opportunity to further contribute to this discussion and would be happy to answer any questions.

**SUBCOMMITEE ON OVERSIGHT AND INVESTIGATIONS**
**OF THE**
**HOUSE COMMITTEE ON**
**FINANCIAL SERVICES**

**HEARING ON**
**"WHAT BORROWERS NEED TO KNOW**
**ABOUT CREDIT SCORING MODELS AND CREDIT SCORES"**

**July 29, 2008**

**Testimony of:**

**Richard G. Goerss**
Chief Privacy Officer and Regulatory Counsel
Equifax Inc.
1555 Peachtree Street, NW
Atlanta, GA 30309

**INTRODUCTION**

Mr. Chairman and members of the Subcommittee, I am Richard Goerss, Chief Privacy Officer and Regulatory Counsel for Equifax Inc. I want to thank you for this opportunity to testify regarding what borrowers need to know about credit scoring models and credit scoring. My testimony primarily is focused on our Equifax Information Services subsidiary, which is our Fair Credit Reporting Act (FCRA)[1]-regulated credit reporting business, which for purposes of convenience, I will refer to simply as Equifax. In addition, given the focus of the hearing, my testimony focuses on scores and scoring models used by our lender customers, as opposed to scores used by others, such as insurers.

This statement briefly describes Equifax Inc.; describes what a credit score is; discusses benefits credit scoring provides to both consumers and lenders; discusses Equifax's scoring models and scores; and explains how consumers can obtain their credit score directly from Equifax.

**ABOUT EQUIFAX**

Founded in 1899, Equifax Inc. is the oldest, the largest, and the only U.S. publicly traded of the national companies that provide consumer information for credit and other risk assessment decisions. As one of the three "national" credit reporting agencies, Equifax's activities are highly regulated under the FCRA and other related federal and state statutes. Equifax is a

[1] 15 U.S.C. Sec. 1681 *et. seq.*

responsible steward of sensitive consumer information and, as such, is committed to consumer privacy. We actively work with governments, consumers, and businesses to forge effective solutions to complex information and privacy issues. Equifax believes that the marketplace can offer solutions that enlighten, enable and empower consumers.

**WHAT IS A CREDIT SCORE?**

A credit score, broadly speaking, is an analytical methodology used to objectively assist in the prediction of consumer credit behavior. Credit scores allow lenders to project future account behavior more precisely, allocate their resources more efficiently, and minimize risk throughout the life cycle of an account. Credit scores may be used in connection with a variety of purposes, such as opening new accounts, determining down payment or deposit amounts, establishing and reviewing credit limits, and prioritizing collection efforts. Lenders can obtain scores based on credit scoring models developed by third parties, such as Equifax or Fair Isaac, or they can develop their own scoring models and obtain credit reports from Equifax (or other consumer reporting agencies) to which those scoring models are applied.

Credit scores are tools that lenders can use to assist in evaluating a consumer transaction or an account. Any decisions – such as whether to lend to a borrower or what terms to offer the borrower – are made by the lender, not those creating the scoring model or supplying credit information for use in the generation of the credit score. Lenders determine the role credit scores have in their credit risk decisions. For example, in the case of a mortgage loan, credit scores are not the sole factor in their decision as other factors, such as the value of the property, loan to

value ratios, the size of the down payment, and the consumer's debt to income ratio commonly would be considered in a lender's decision. Three lenders obtaining the same credit score on the same day could chose to offer the consumer different loan products or rates depending upon their underwriting decisions.

## BENEFITS OF CREDIT SCORING TO CONSUMERS AND LENDERS

Credit scoring systems provide benefits for both consumers and lenders. According to last year's report to the Congress by the Federal Reserve Board, "the introduction of credit-scoring systems has increased the share of applications that are approved for credit, reduced the costs of underwriting and soliciting new credit, and increased the speed of decision making." Examples of other benefits of credit scoring, also identified in the Federal Reserve Report, include:[2]

- Credit scoring has promoted competition between lenders by making it possible for creditors to readily solicit business from their competitors.
- Credit scoring increases the consistency and objectivity of credit evaluation and therefore may reduce the possibility that credit decisions will be influenced by personal characteristics or other factors prohibited by law.
- Credit scoring increases the efficiency of consumer credit markets by helping creditors establish pricing that is more consistent with the risks and costs involved.
- Credit scoring has broadened creditor access to capital markets, thereby reducing the cost of funding loans and strengthening public and private scrutiny of lending activities.

[2] Board of Governors of the Federal Reserve System, "Report to the Congress on Credit Scoring and its Effects on the Availability and Affordability of Credit: Submitted to the Congress pursuant to Section 215 of the Fair and Accurate Credit Transactions Act of 2003" (Aug. 2007). pp. O-4 – O-5.

**CREDIT SCORES OFFERED BY EQUIFAX**

Equifax markets third-party credit scores, including the FICO® score (sometimes also referred to as the Beacon score when sold by Equifax) and the VantageScore.[3] Equifax also has developed scoring models of its own. Also, as noted above, some customers choose to develop their own scoring models and then purchase consumer credit reports from Equifax to use with their own models in connection with the lender's credit determinations. As we understand that Fair Isaac, developer of the FICO score, has been invited to testify at today's hearing about its scoring models, we will focus our testimony on a description of our own scoring models.

Equifax develops hundreds of credit models for use by its customers. Equifax credit scores predict the likelihood of a particular behavior, such as payment, delinquency, or bankruptcy, within a set time period. Of course, Equifax credit scores are not a guarantee that a defined behavior will occur and do not use factors, such as gender, race, color, national origin, marital status, religion, or address. Nor do we use age as a factor.

Equifax credit scores are mathematically-derived and correlated to actual historical performance. Scores also are consistent, objective, and free from bias. Scores are an alternative to judgmental decision making, which typically is based on the experience of the decision makers, may be influenced by professional intuition, and can be biased or influenced by emotional states or consideration. Regulation B,[4] which implements the Equal Credit

[3] VantageScore is an alternative to the FICO score created by Equifax, Experian, and TransUnion.
[4] 12 C.F.R. Part 202.

Opportunity Act,[5] addresses creditor use of credit scoring models and the development and validation practices that distinguish what the Regulation refers to as an "empirically sound, demonstrably and statistically sound" credit scoring system from judgmental assessments of applicants.

Equifax scoring models typically assign higher scores to consumers who exhibit a likelihood of high or satisfactory credit performance and lower scores to consumers who exhibit a likelihood of low or unsatisfactory performance. Our scores potentially are based on hundreds of discrete factual items of information, commonly referred to as "factors." The factors can be broadly grouped into categories such as payment history, amounts owed, length of credit history, new credit account activity, and the types of credit used (installment, revolving, etc.). The weighting of particular factors varies from model to model depending upon how that factor impacts the type of behavior or outcome that the scoring model is seeking to predict. For example, the Equifax FICO (Beacon) score weighs the broad categories of factors described above as follows:

- Payment history (approximately 35%)
- Amounts owed/utilized (approximately 30%)
- Length of credit history (approximately 15%)
- New credit (approximately 10%)
- Type of credit (approximately 10%)

[5] 15 U.S.C. Sec. 1691 *et. seq.*

Equifax offers both custom and generic credit scoring models. A "generic" credit score is derived from a scoring model that has been designed on the basis of information from a sampling of the general population. A "custom" credit score is a score that is based on scoring model that has been developed on the basis of a sampling of a more specific population, such as a specific lender's customers.

Equifax scores are based on information in a consumer's Equifax file, which is subject to the full range of standards, rights, and protections, afforded by the FCRA. Information used in scoring Equifax scoring models may include tradeline information regarding a consumer's credit accounts (such as the type of account, the date the account was opened, the credit limit or loan amount, the outstanding balance, and the consumer's payment history); inquiry information regarding certain inquiries (discussed further below); and public record or collection information such as certain judgments, tax liens, and collection account information. Credit reports also include identifying information about consumers, but this information is not used as factors in a credit scoring model.

Equifax does not score files in cases where the consumer's file either has no tradelines, no tradeline that has been open for more than six months, or no tradeline that has been updated within the last six months. Disputed items in a consumer's file are not used in Equifax scores. In addition, authorized-user tradelines generally are excluded from Equifax scoring models.

Equifax scoring models may utilize inquiries arising from consumer-initiated transaction – such as applications for auto loans, credit cards, mortgages, home equity lines, or retail credit

cards – in the calculation of credit scores, however, these inquiries are not heavily weighted. Inquiries arising from non-consumer initiated transactions, such as account review, pre-approved offers of credit, and consumer disclosure requests are not used by Equifax scoring models.

Information that may be predictive of creditworthiness, other than those customarily found in the traditional credit report, often are commonly referred to as "alternative data." Alternative data sources might include, for example, utility payment history information, telecommunications history information, rental payment history information, or checking and savings account information. The use of such information, once collected, in credit scoring models would require continuing study, looking both at its content and the ability of alternative data providers to meet their FCRA furnisher obligations. Equifax already captures some types of alternative data and is committed to developing additional sources of alternative data so as to assist in scoring thin-filed and "un-banked" consumers.

**HOW CONSUMERS CAN OBTAIN CREDIT SCORES FROM EQUIFAX**

Consumers can obtain the FICO/Beacon score, which is the credit scoring model most commonly distributed by Equifax, based on information in the consumer's Equifax credit file from Equifax Information Services in a variety of ways. In each case, the price paid by consumers for the score disclosure is $7.95:[6]

[6] Consumers also may obtain their credit scores through other sources. For example, consumers are entitled under the FCRA, as amended by FACTA, to receive their credit score in connection with certain mortgage transactions. See FCRA Sec. 609(g) (15 U.S.C. Sec. 1681g(g)).

- Consumers can request a FICO credit score alone (without a copy of their credit file, credit monitoring, or ongoing scoring products) by sending a written request with proof of identity or by calling us, toll free, at 1-877-SCORE-11 (1-877-726-7311) or 1-800-685-1111. Consumers calling these toll-free numbers also have the option to order their FICO score together with a copy of their Equifax credit file, and the option to order a copy of their Equifax credit file without a score.

  In addition to the consumer's FICO score, the consumer also is provided with the key scoring factors that affected the consumer's credit score, the FTC's summary of consumer rights under the Fair Credit Reporting Act, and other information. An example of such a disclosure is provided with our testimony as Attachment A.

- Consumers who obtain their free FACTA annual file disclosure from Equifax through annualcreditreport.com can also purchase their FICO credit score along with their free annual file disclosure, if they wish to do so.

- Consumers entitled to free credit file disclosures under FCRA or state law for various reasons (other than the FACTA free annual file disclosures, which are handled through the centralized source at annualcreditreport.com, discussed above) can request free credit file disclosure at www.equifax.com/fcra. These consumers are also offered the opportunity to purchase their FICO credit score.

In addition, our Equifax Personal Solutions subsidiary, which offers services and products directly to consumers, also makes credit scores available to consumers as a component of credit file monitoring products or credit scoring and credit scoring monitoring products such as Credit Watch™, Score Power®, and ScoreWatch™. These products, which vary in cost, are available to consumers through Equifax.com.

We also make educational information available to consumers through our website, www.Equifax.com. Examples of these materials accompany our testimony as Attachment B.

**CONCLUSION**

Thank you again for the opportunity to testify on this important issue. Credit scoring has important benefits for both consumers and lenders. Equifax looks forward to continuing to work with the Subcommittee on scoring issues and educating consumers as to what they need to know, as borrowers, about credit scoring models and credit scores.

## RICHARD G. GOERSS

## CHIEF PRIVACY OFFICER
## AND REGULATORY COUNSEL

Richard G. Goerss is Chief Privacy Officer and Regulatory Counsel. He was appointed to these positions in April 2005 after having served as Vice President and Corporate Regulatory Counsel for various Equifax companies since March 2001. He had responsibility for regulatory and compliance issues on a global basis.

Previously, prior to March 2001, Mr. Goerss had served as Vice President - Group Counsel, North American Information Services for Equifax. He was responsible for a broad range of legal services to Equifax domestic credit services operations. Before that, Mr. Goerss served as Vice President - Assistant Group Counsel from 1993 until 1996 and as Vice President of Equifax Credit Information Services from 1991 until 1993. He has held various leadership positions since joining Equifax in 1977.

Mr. Goerss earned both a Bachelor of Arts degree with honors and a Master of Arts degree in teaching in 1972 from Emory University. In 1977, he received a Juris Doctor degree with honors from the University of Georgia.

**ATTACHMENT A**

P O Box 740256
Atlanta, GA 30374

July 24, 2008

000006562-1
Cshelltest Cshell Ctest
211 Perimeter Center Pkwy NE
Atlanta, GA 30346-1308

Dear Cshelltest Cshell Ctest:

Thank you for requesting your credit score. Credit scores are generated by applying a risk scoring model to information in an individual's credit file.

| **Your FICO ® credit score of 650** |
|---|
| **was created on July 24, 2008 and was based on the contents of your Equifax credit file on that date.** |
| The credit scoring model most commonly distributed by Equifax is FICO ®. A FICO ® credit score is generated from a formula developed by Fair, Issac and Company, Inc. |

**NOTE:** The range of possible FICO ® credit scores is 300 to 850. Generally, the higher the score the more favorably it is viewed by a lender.

| ***The key factors that affected your credit score are:*** | |
|---|---|
| **Reason Code** | **Explanation** |
| 38 | Serious delinquency or derogatory indicators/remarks, and public record or collection information is being reported on your credit file |
| 18 | There is evidence of multiple accounts with missing payments or having derogatory indicators/remarks reported |
| 13 | The time since your most recent past due payment is too recent or unknown |
| 16 | There is a lack of recent revolving/charge account information on your credit file |

The above information and credit scoring model may be different than the credit score used by a lender. Lenders and other credit grantors may use their own custom scoring model or one developed by another company.

The confirmation number for this Score Report is: **8206000039**. If you need to speak with a customer service representative concerning the information on this Score Report, please call (800) 435-7730 and have the Score Report confirmation number available.

You may wish to view the contents of your Equifax credit file. To receive your credit file via the Postal Service, please order it from our automated system at **1-800-685-1111**. For instant on-line access to your credit file log on to ***www.equifax.com***.

You may contact Fair Isaac online at: ***www.fairisaac.com*** or by mail at: **Fair Isaac Corporation, 901 Marquette Avenue, Suite 3200, Minneapolis, MN 55402 USA.**

**The FBI Has Named Identity Theft As The Fastest Growing Crime In America.**
Protect yourself with Equifax Credit Watch™, a service that monitors your credit file every business day and notifies you within 24 hours of any activity. To order, go to: ***www.creditwatch.equifax.com***

***Para información en español, visite www.ftc.gov/credit o escribe a la FTC Consumer Response Center, Room 130-A 600 Pennsylvania Ave. N.W., Washington, D.C. 20580.***

***A Summary of Your Rights Under the Fair Credit Reporting Act***

The federal Fair Credit Reporting Act (FCRA) promotes the accuracy, fairness, and privacy of information in the files of consumer reporting agencies. There are many types of consumer reporting agencies, including credit bureaus and specialty agencies (such as agencies that sell information about check writing histories, medical records, and rental history records). Here is a summary of your major rights under the FCRA. **For more information, including information about additional rights, go to www.ftc.gov/credit or write to: Consumer Response Center, Room 130-A, Federal Trade Commission, 600 Pennsylvania Ave. N.W., Washington, D.C. 20580.**

- **You must be told if information in your file has been used against you.** Anyone who uses a credit report or another type of consumer report to deny your application for credit, insurance, or employment or to take another adverse action against you must tell you, and must give you the name, address, and phone number of the agency that provided the information.

- **You have the right to know what is in your file.** You may request and obtain all the information about you in the files of a consumer reporting agency (your "file disclosure"). You will be required to provide proper identification, which may include your Social Security number. In many cases, the disclosure will be free. You are entitled to a free file disclosure if:

  - a person has taken adverse action against you because of information in your credit report;
  - you are the victim of identify theft and place a fraud alert in your file;
  - your file contains inaccurate information as a result of fraud;
  - you are on public assistance;
  - you are unemployed but expect to apply for employment within 60 days.

  In addition, by September 2005 all consumers will be entitled to one free disclosure every 12 months upon request from each nationwide credit bureau and from nationwide specialty consumer reporting agencies. See www.ftc.gov/credit for additional information.

- **You have the right to ask for a credit score.** Credit scores are numerical summaries of your credit-worthiness based on information from credit bureaus. You may request a credit score from consumer reporting agencies that create scores or distribute scores used in residential real property loans, but you will have to pay for it. In some mortgage transactions, you will receive credit score information for free from the mortgage lender.

- **You have the right to dispute incomplete or inaccurate information.** If you identify information in your file that is incomplete or inaccurate, and report it to the consumer reporting agency, the agency must investigate unless your dispute is frivolous. See www.ftc.gov/credit for an explanation of dispute procedures.

- **Consumer reporting agencies must correct or delete inaccurate, incomplete, or unverifiable information.** Inaccurate, incomplete or unverifiable information must be removed or corrected, usually within 30 days. However, a consumer reporting agency may continue to report information it has verified as accurate.

- **Consumer reporting agencies may not report outdated negative information.** In most cases, a consumer reporting agency may not report negative information that is more than seven years old, or bankruptcies that are more than 10 years old.
- **Access to your file is limited.** A consumer reporting agency may provide information about you only to people with a valid need -- usually to consider an application with a creditor, insurer, employer, landlord, or other business. The FCRA specifies those with a valid need for access.
- **You must give your consent for reports to be provided to employers.** A consumer reporting agency may not give out information about you to your employer, or a potential employer, without your written consent given to the employer. Written consent generally is not required in the trucking industry. For more information, go to www.ftc.gov/credit.
- **You may limit "prescreened" offers of credit and insurance you get based on information in your credit report.** Unsolicited "prescreened" offers for credit and insurance must include a toll-free phone number you can call if you choose to remove your name and address from the lists these offers are based on. You may opt-out with the nationwide credit bureaus at 1-888-5-OPTOUT (1-888-567-8688).
- **You may seek damages from violators.** If a consumer reporting agency, or, in some cases, a user of consumer reports or a furnisher of information to a consumer reporting agency violates the FCRA, you may be able to sue in state or federal court.
- **Identity theft victims and active duty military personnel have additional rights.** For more information, visit www.ftc.gov/credit.

**States may enforce the FCRA, and many states have their own consumer reporting laws. In some cases, you may have more rights under state law. For more information, contact your state or local consumer protection agency or your state Attorney General. Federal enforcers are:**

| TYPE OF BUSINESS: | CONTACT INFORMATION: |
|---|---|
| Consumer reporting agencies, creditors and others not listed below | Federal Trade Commission, Consumer Response Center - FCRA<br>Washington, DC 20580 1-877-382-4357 |
| National banks, federal branches/agencies of foreign banks (word "National" or initials "N.A." appear in or after bank's name) | Office of the Comptroller of the Currency<br>Compliance Management, Mail Stop 6-6<br>Washington, DC 20219 800-613-6743 |
| Federal Reserve System member banks (except national banks, and federal branches/agencies of foreign banks) | Federal Reserve Board<br>Division of Consumer & Community Affairs<br>Washington, DC 20551 202-452-3693 |
| Savings associations and federally chartered savings banks (word "Federal" or initials "F.S.B." appear in federal institution's name) | Office of Thrift Supervision<br>Consumer Complaints<br>Washington, DC 20552 800-842-6929 |
| Federal credit unions (words "Federal Credit Union" appear in institution's name) | National Credit Union Administration<br>1775 Duke Street<br>Alexandria, VA 22314 703-518-6360 |
| State-chartered banks that are not members of the Federal Reserve System | Federal Deposit Insurance Corporation<br>Consumer Response Center, 2345 Grand Avenue, Suite 100<br>Kansas City, Missouri 64108-2638 1-877-275-3342 |
| Air, surface, or rail common carriers regulated by former Civil Aeronautics Board or Interstate Commerce Commission | Department of Transportation , Office of Financial Management<br>Washington, DC 20590 202-366-1306 |
| Activities subject to the Packers and Stockyards Act, 1921 | Department of Agriculture<br>Office of Deputy Administrator - GIPSA<br>Washington, DC 20250 202-720-7051 |

***Para información en español, visite www.consumer.gov/idtheft o escribe a la FTC, Consumer Response Center, Room 130-B, 600 Pennsylvania Avenue, N.W. Washington, D.C., 20580.***

**Remedying the Effects of Identity Theft**

You are receiving this information because you have notified a consumer reporting company that you believe that you are a victim of identity theft. Identity theft occurs when someone uses your name, Social Security number, date of birth, or other identifying information, without authority, to commit fraud. For example, someone may have committed identity theft by using your personal information to open a credit card account or get a loan in your name. For more information, visit www.consumer.gov/idtheft or write to: FTC, Consumer Response Center, Room 130-B, 600 Pennsylvania Avenue, N.W. Washington, D.C., 20580.

The Fair Credit Reporting Act (FCRA) gives you specific rights when you are, or believe that you are, the victim of identity theft. Here is a brief summary of the rights designed to help you recover from identity theft.

1. **You have the right to ask that nationwide consumer reporting companies place "fraud alerts" in your file** to let potential creditors and others know that you may be a victim of identity theft. A fraud alert can make it more difficult for someone to get credit in your name because it tells creditors to follow certain procedures to protect you. It also may delay your ability to obtain credit. You may place a fraud alert in your file by calling just one of the three nationwide consumer reporting agencies. As soon as that agency processes your fraud alert, it will notify the other two, which then also must place fraud alerts in your file.

   * Equifax: 1-800-525-6285 www.equifax.com
   * Experian: 1-888-397-3742 www.experian.com
   * TransUnion: 1-800-680-7289 www.transunion.com

   An initial fraud alert stays in your file for at least 90 days. An extended alert stays in your file for seven years. To place either of these alerts, a consumer reporting agency will require you to provide appropriate proof of your identity, which may include your Social Security number. If you ask for an extended alert, you will have to provide an *identity theft report*. An *identity theft report* includes a copy of a report you have filed with a federal, state, or local law enforcement agency, and additional information a consumer reporting agency may require you to submit. For more detailed information about the *identity theft report*, visit www.consumer.gov/idtheft.

2. **You have the right to free copies of the information in your file (your "file disclosure").** An initial fraud alert entitles you to a copy of all the information in your file at each of the three nationwide agencies, and an extended alert entitles you to two free file disclosures in a 12-month period following the placing of the alert. These additional disclosures may help you detect signs of fraud, for example, whether fraudulent accounts have been opened in your name or whether someone has reported a change in your address. Once a year, you also have the right to a free copy of the information in your file at any consumer reporting agency, if you believe it has inaccurate information due to fraud, such as identity theft. You also have the ability to obtain additional free file disclosures under other provisions of the FCRA. See www.ftc.gov/credit.

3. **You have the right to obtain documents relating to fraudulent transactions made or accounts opened using your personal information.** A creditor or other business must give you copies of applications and other business records relating to transactions and accounts that resulted from the theft of your identity, if you ask for them in writing. A business may ask you for proof of your identity, a police report, and an affidavit before giving you the documents. It also may specify an address for you to send your request. Under certain circumstances, a business can refuse to provide you with these documents. See www.consumer.gov/idtheft.

4. **You have the right to obtain information from a debt collector.** If you ask, a debt collector must provide you with certain information about the debt you believe was incurred in your name by an identity thief - like the name of the creditor and the amount of the debt.

5. **If you believe information in your file results from identity theft, you have the right to ask that a consumer reporting agency block that information from your file.** An identity thief may run up bills in your name and not pay them. Information about the unpaid bills may appear on your consumer report. Should you decide to ask a consumer reporting agency to block the reporting of this information, you must identify the information to block, and provide the consumer reporting agency with proof of your identity and a copy of your *identity theft report*. The consumer reporting agency can refuse or cancel your request for a block if, for example, you don't provide the necessary documentation, or where the block results from an error or a material misrepresentation of fact made by you. If the agency declines or rescinds the block, it must notify you. Once a debt resulting from identity theft has been blocked, a person or business with notice of the block may not sell, transfer, or place the debt for collection.

6. **You also may prevent businesses from reporting information about you to consumer reporting agencies if you believe the information is a result of identity theft.** To do so, you must send your request to the address specified by the business that reports the information to the consumer reporting agency. The business will expect you to identify what information you do not want reported and to provide an *identity theft report*.

To learn more about identity theft and how to deal with its consequences, visit www.consumer.gov/idtheft, or write to the FTC. You may have additional rights under state law. For more information, contact your local consumer protection agency or your state attorney general.

In addition to the new rights and procedures to help consumers deal with the effects of identity theft, the FCRA has many other important consumer protections. They are described in more detail at www.ftc.gov/credit.

To request a free copy of your credit file after adding an initial or extended fraud alert please contact our automated ordering system at 1-800-685-1111. If you believe that the your credit file may contain inaccurate information due to fraud, such as identity theft, please submit your request in writing to:

Equifax Information Services LLC
P.O. Box 740250
Atlanta, GA 30374-0250

**ATTACHMENT B**

EQUIFAX

# FCRA

## Your Credit Rights
## Key Rights Contained in the Fair Credit Reporting Act (FCRA)

The Fair Credit Reporting Act (FCRA) is a federal law that regulates how credit reporting agencies use your information. Enacted in 1970 and substantially amended in the late 1990s and again in 2003, the FCRA restricts who has access to your sensitive credit information and how that information can be used.

### Summary of Key Rights

The FCRA is a complex piece of legislation and contains numerous provisions not discussed on this page. Below are several important features of how the FCRA that are designed to help consumers (for the complete text, visit the Federal Trade Commission). The FCRA protects you by ensuring that credit reporting agencies:

**Disclose your credit report to you upon request.** Credit reporting agencies must give you the information in your file if you ask for it and provide the agency with proper identification. See "To Receive Your Credit Report" below for more information.

**Limit access to your information.** A credit reporting company may not provide your credit report to any party that lacks a permissible purpose, such as the evaluation of an application for a loan, credit, service, or employment. Permissible purposes also include several business and legal uses. For details, see the FCRA.

**Get your consent before providing your information to an employer.** An agency may not give your credit information to an employer or potential employer unless you first give that employer written permission to request your credit.

**Investigate disputed information.** If you tell a credit reporting company that your file contains inaccurate information, the agency must promptly investigate the matter with the source that provided the information. If the investigation fails to resolve the dispute, you may add a statement explaining the matter to your credit file. For more information, see Correcting Errors in Your Report.

**Correct or delete inaccurate information.** A credit reporting company must correct or, as the case may be, delete from your credit file the information that is found to be inaccurate or can no longer be verified from your credit file. The credit reporting company is not required to remove accurate data from your file unless it is outdated or cannot be verified.

**Delete outdated information.** In general, negative information that is more than 7 years old (10 years for bankruptcies) must be removed from your file.

**Remove your name from marketing lists upon request.** Creditors and insurers may share information in your credit file with marketers who send you unsolicited offers. To request that the three credit reporting agencies not share your information with marketers, call 888-567-8688.

**Disclose your credit score to you upon request.** For a fee, you may get your credit score. In some mortgage transactions, you will get credit score information without charge. See "To Obtain Your Credit Score" below for more information.

**Add identity theft and active duty alerts.** Identity theft victims may place fraud alerts and active duty military personnel serving away from their regular duty station may place "active duty" alerts to help prevent identity theft.

**Remedying the Effects of Identity Theft.** If you are, or believe that you are, the victim of identity theft, you have specific rights under the FCRA. These rights will help you deal with the effects of identity theft. Click here to view a brief summary of the rights designed to help you recover from identity theft.

**Place a Security Freeze on your Credit File.** If you reside in select states you have the right to place a security freeze on your Equifax credit file. To determine the availability of a security freeze for your state and to determine the fees for placing and temporarily lifting a security freeze, please see the State Freeze Requirements and Fees. A security freeze will prevent us from reporting your Equifax credit file to third parties, such as credit grantors and other companies and agencies, except those exempted by law or those for whom you contacted us and requested that we temporarily lift the security freeze.

A security freeze will require you to plan ahead for all your credit applications as you will need to contact us to request that we temporarily lift your freeze to allow us to report your Equifax credit file to the credit grantor you identify. Under the laws of most states, it may take up to three business days to process your request to temporarily lift the security freeze. It may take longer if you have lost the security freeze confirmation number which we provided to you when you first requested the security freeze be placed on your Equifax credit file. You may not be able to request a temporary lift of a security freeze during non-business hours or on weekends. A security freeze may hinder your ability to immediately obtain credit to make major purchases. Again, if you are credit active and apply for credit on a regular basis and have a security freeze on your Equifax credit file you need to be especially mindful of the need to plan ahead and contact us in advance to request a temporary lift of the security freeze on your Equifax credit file.

Only you can request a security freeze be placed on your Equifax credit file and only you can request the security freeze be removed or temporarily lifted. A security freeze will remain on your Equifax credit file until you request the security freeze be permanently removed or you request a temporary lift of the security freeze for a specific credit grantor/credit file user, or date range.

If you choose to request a security freeze on your Equifax credit file you must write to us. Your written request must be sent via certified mail and include the following information:

1. Name
2. Address
3. Date of Birth
4. Social Security Number
5. Proof of current address such as a current utility bill
6. Payment of applicable fees to request a security freeze of your credit file ( State Freeze Requirements and Fees to determine fees for your state). We accept personal checks, American Express, Mastercard, VISA, and Discover Cards for payment of fees. If you are paying by credit card, please include the following information:
    a. Name of the person as it appears on the credit card
    b. Type of credit card (American Express, Mastercard, VISA, or Discover Card)
    c. Complete account number
    d. Expiration date (month and year)
    e. For American Express - 4 digit Card Identification Number (on front of card above the account number)
    f. For Mastercard, VISA, or Discover Card - 3 digit Card Number (on back of card at the end of the account )
    Please do not send cash through the mail.
    g. If you are an identity theft victim and are requesting a security freeze you must also include a copy of a police report, Identity Theft report, or other government law enforcement agency report, such as a DMV report.

Please send your security freeze request information via certified mail to the address below.

*Equifax Security Freeze*
*P.O. Box 105788*
*Atlanta, Georgia 30348*

Once we receive your security freeze request information and place a security freeze on your Equifax credit file we will send you via US mail a confirmation letter that contains a 10 digit security freeze confirmation number. You will need to provide us your security freeze confirmation number to request temporary lifts of your security freeze or permanent removal of your security freeze. Please store this confirmation letter in a safe place to prevent delays when requesting a temporary lift or removal of your security freeze.

**To Receive Your Credit Report**

This chart outlines fees by state for requesting one or more copies of your credit file within one calendar year (unless otherwise stated).

| State | Free | Fees |
|---|---|---|
| California | | $ 8.00 |
| Colorado | 1 per calendar year | $ 8.00 |
| Connecticut | | $ 5.00 for the first report , $ 7.50 for each additional report within 12 months |
| Georgia | 2 per calendar | $ 10.00 |
| Maine | 1 within 12 months | $ 5.00 |
| Maryland | 1 within 12 months | $ 5.00 |
| Massachusetts | 1 per calendar year | $ 8.00 |
| Minnesota | | $ 3.00 for the first report, $ 10.00 for each additional report within 12 months |
| Montana | | $ 8.50 |
| New Jersey | 1 within 12 months | $ 8.00 |
| US Virgin Islands | | $ 1.00 |
| Vermont | 1 within 12 months | $ 7.50 |
| All other states | | $ 10.00 |
| *Unemployed | 1 within 12 months | |
| *Welfare | 1 within 12 months | |

You are entitled to one free report during any 12-month period no matter where you live, if you:

Are unemployed and intend to apply for employment in the next 60 days

- Are on public welfare assistance
- Believe your file contains inaccurate information due to fraud
- You are also entitled to a free report if you have received notice of an adverse decision (such as denial of credit, insurance, or employment) within the past 60 days

To receive your free Equifax credit report:

- Visit www.equifax.com/fcra (This is the quickest and easiest way to gain instant access to your credit report)

- Call 800-685-1111 -OR-
- Write to:
  Equifax Information Services
  P.O. Box 740241
  Atlanta, GA 30374

When requesting a credit report by mail, be sure to include your full name, current address, Social Security Number, and most recent former address for file-matching purposes. Also include a personal check made payable to Equifax Information Services LLC, based on the state rates above.

For immediate access to your online Equifax Credit Report&trade Click here. A $10.00 service fee applies.

Under the FACT Act amendments to the Fair Credit Reporting Act you are entitled to one free credit report disclosure in a 12 month period. To request this free annual disclosure you must contact the Central Source. To contact the Central Source on-line, please click here to www.annualcreditreport.com. You can also contact the Central Source to request this free annual disclosure by calling toll free (877) FACTACT or by using the mail request form available at the central source website by clicking the following link www.annualcreditreport.com

### To Obtain Your Credit Score

By law, you are entitled to obtain your credit score. There is a fee of $7.95 to obtain your credit score from Equifax Information Services. To request your credit score, please contact:

*Equifax Information Services LLC*
*PO Box 105252*
*Atlanta, GA 30348*
*or call 1-877-SCORE-11*

If you are in the process of obtaining a mortgage, you may be entitled to free credit score information. Contact the person making or arranging your loan for further information.

## Understanding Credit Scores

Print this page

Looking for the ability to improve your attractiveness to lenders by improving your credit score? There's good reason to do so -- a higher score can provide you a greater array of financial options and more favorable credit offers. Even if you already have a good score, there's always room for improving your creditworthiness by understanding your credit score. Keep in mind, however, that your credit score is based on your history of borrowing and repaying money, so there's no way to instantly change it. But here are some effective strategies that can help to strengthen your creditworthiness over time.

### Top 10 Strategies That May Help You

**10.** Learn what your current FICO® credit score is and what appears on your credit report. Score Power® gives you immediate access to your Equifax Credit Report and includes your current FICO® credit score.

**9.** Don't open new credit cards that you don't need just to increase your available credit. This approach could backfire and actually lower your score.

**8.** Try to keep your total account balances as low as possible. High outstanding debt may negatively affect your score, as you have a greater chance of missing payments.

**7.** Correct any incorrect information that might appear on your credit report. Visit Disputing Information on Your Report for more information.

**6.** If your credit is severely damaged, or you have a very short credit history, there are still ways to improve your creditworthiness over time. Consider opening new accounts responsibly and paying them off on time.

**5.** If you fall behind on paying a bill because of illness, unemployment, or family issues, write a short explanation to the credit reporting agencies. They will add it to your credit report. Also, call your creditor to explain the circumstances and, if possible, work out a payment schedule you can meet.

**4.** If you need help managing your credit, contact a reliable nonprofit agency, such as:
Consumer Credit Counseling Service (CCCS)
800-388-2227
www.cccsintl.org

**3.** To minimize the number of inquiries on your credit report, don't apply for multiple credit cards over a short period of time, or for a card you're not likely to get. Apply for new credit accounts only as needed.

**2.** Make all of your payments on time. If forced to miss a payment, be sure to pay the missed payment the following month along with the current payment. Accounts more that are past due will be indicated on your credit report. If you have missed payments, get current and stay current. As a general rule, the longer you pay your bills on time, the better your score.

**And the number one way...?**

**1.** Continue to check your credit report regularly, charting your progress along the way. Get your FICO® score and your Equifax Credit Report today with Score Power®!

## Frequently Asked Questions for Free and Discounted Disclosures

### General Questions

**Why can't I access my credit file online?**

If you are unable to pass authentication at Equifax's Free and Discounted Disclosures site, your credit file will not be delivered online. If you are unable to pass authentication, you can request your credit file be mailed to the address you supplied during registration through the Equifax Free and Discounted Disclosures site or by contacting us at 1-800-685-1111.

**What information is included in my Equifax credit file?**

Your Equifax credit file includes identifying information, trade line information, inquiry information, public record and collection information.

- Identifying information includes information that is used to identify you such as your name, address, social security number, date of birth and employment information. This information is not used in scoring. Updates to this information come from information you supply to lenders.
- Trade lines are your credit accounts. Lenders report on each account you have established with them. They report the type of account (bankcard, auto loan, mortgage, etc), the date you opened the account, your credit limit or loan amount, the account balance and your payment history.
- Inquiry information contains information about companies that have requested and/or viewed your credit information and remain up to two years.
- Public Record and/or Collection Information - Your credit file may contain public record information such as judgments, tax liens, and bankruptcies. Your credit file may also contain collection account information from professional services e.g. doctors, hospitals, cable companies etc. that have been turned over to an outside collection agency. Not all credit files contain public record and/or collection information.

**How do I request a "fraud alert" be placed on my file?**

You have the right to ask that nationwide consumer credit reporting companies place "fraud alerts" in your file to let potential creditors and others know that you may be, or have been a victim of identity theft. A fraud alert can make it more difficult for someone to get credit in your name because it tells creditors to follow certain procedures to protect you. It also may delay your ability to obtain credit. You may place a fraud alert in your file by calling just one of the three nationwide consumer credit reporting companies. As soon as that agency processes your fraud alert, it will notify the other two, which then also must place fraud alerts in your file.

- Equifax: 1-800-525-6285; www.equifax.com
- Experian: 1-888-397-3742; www.experian.com/fraud
- TransUnion: 1-800-680-7289; www.transunion.com

An ***initial fraud alert*** stays in your file for at least 90 days. An ***extended alert*** stays in your file for seven years. To place either of these alerts, a consumer credit reporting company will require you to provide appropriate proof of your identity, which may include your Social Security number. If you ask for an extended alert, you will have to provide an identity theft report. An identity theft report includes a copy of a report you have filed with a federal, state, or local law enforcement agency. For more detailed information about the identity theft report, visit www.consumer.gov/idtheft.

**How do I dispute inaccuracies on my Equifax credit file?**

As stated in the FCRA, you have the right to dispute information that you feel is being reported incorrectly on your Equifax credit file. You are able to initiate an online investigation immediately or you can contact our dispute center at the toll-free number listed at the top of your Equifax credit file. You must have a current copy of your Equifax credit file and your 10-digit confirmation number to complete this process online, which is found at the top of your Equifax credit file.

To initiate an online investigation, visit www.equifax.com/investigate

This link will lead you to a page that is not screen-readable at this time.
. Your investigation requests are covered by the FCRA.

Additionally, you can dispute inaccuracies via US mail by writing to:

Equifax Information Services LLC
P.O. Box 740256
Atlanta, GA 30374

**What is a credit file disclosure?**

A credit file disclosure provides you with all of the information in your credit file maintained by a consumer reporting company, such as Equifax that could be provided by the consumer reporting company about you to a third party, such as a lender. A credit file disclosure also includes a record of everyone who has received a consumer file about you from the consumer reporting company within a certain period of time ("inquiries"). The credit file disclosure includes certain information that is not included in a consumer file about you to a third party, such as the inquiries of companies for pre-approved offers of credit or insurance and account reviews, and any medical account information which is suppressed for third party users of consumer files. You are entitled to receive a disclosure copy of your credit file from a consumer reporting company under Federal law and the laws of various states.

**What is a credit score?**

A credit score is a complex mathematical model that evaluates many types of information in a credit file. A credit score is used by a lender to help determine whether a person qualifies for a particular credit card, loan, or service. Most credit scores estimate the risk a company incurs by lending a person money or providing them with a service — such as, the likelihood that the person will make payments on time in the next two to three years. Generally, the higher the score, the less risk the person represents.

**How can I get my Equifax credit score?**

You can purchase an Equifax credit score when you request your Equifax credit file through the Free and Discounted Disclosures for a fee of $7.95.

You can also order your score by phone by calling 1-800-685-1111.

**What about companies that claim they can improve my credit file for a fee?**

The Federal Trade Commission (FTC) cautions consumers to be wary of companies that make claims regarding credit repair. These companies, commonly called credit clinics, don't do anything for consumers that consumers cannot do for themselves at little or no cost. Beware of any organization that offers to create a new identity and credit file for you. The FTC and state attorneys general have filed actions against those who pursue these fraudulent practices. Here are some warning signs that the FTC and others say consumers should look out for to determine if they might be dealing with a credit clinic:

- An organization that guarantees to remove late payments, bankruptcies, or similar information from a credit file
- An organization that charges a lot of money to repair credit
- A company that asks the consumer to write to the credit reporting company and repeatedly seek verification of the same credit account information in the file, month after month, even though the information has been determined to be correct
- An organization that is reluctant to give out their address or one that pushes you to make a decision immediately For a helpful brochure about credit clinics, you can write to the Federal Trade Commission and request a brochure titled "Credit Repair: Self Help May Be Best."

Federal Trade Commission
Sixth and Pennsylvania Avenues, N.W.
Washington, D.C. 20004

Am I entitled to a free credit file under state and federal laws?

The chart below outlines fees by state for requesting one or more copies of your credit file within one calendar year (unless otherwise stated).

| State | Free | Fees |
|---|---|---|
| California | | $8.00 |
| Colorado | 1 per calendar year | $8.00 |
| Connecticut | | $ 5.00 for the first file, $ 7.50 for each additional file within 12 months |
| Georgia | 2 per calendar year | $10.50 |

| | | |
|---|---|---|
| Maine | 1 within 12 months | $5.00 |
| Maryland | 1 within 12 months | $5.00 |
| Massachusetts | 1 per calendar year | $ 8.00 |
| Minnesota | | $ 3.00 for the first file, $ 10.50 for each additional file within 12 months |
| Montana | | $8.50 |
| New Jersey | 1 within 12 months | $8.00 |
| US Virgin Islands | 1 within 12 months | $7.50 |
| Vermont | 1 within 12 months | $7.50 |
| All other states | | $10.50 |

**Under the Federal Fair Credit Reporting Act:**

*If you have been denied credit, insurance, change in credit limit, or other credit-based benefit within the last 60 days, you are entitled by law to one free copy of your credit file per calendar year. If you have recently placed an initial 90 day fraud alert on the file, you are entitled to one free credit file. If you have recently placed an extended seven-year alert, you are entitled to two free credit files within 12 months.

**You are entitled to one free credit file during any 12-month period regardless of your state of residence if:

- Unemployed and intend to apply for employment in the next 60 days.
- Receiving public welfare assistance.
- You believe you may be a victim of fraud.

Under the FACT Act amendments to the Fair Credit Reporting Act you are entitled to one free credit file disclosure in a 12 month period. To request this free annual disclosure you may contact the Central Source on-line at www.annualcreditreport.com. You can also contact the Central Source to request this free annual disclosure by calling toll free (877) FACTACT or by using the mail request form available at the central source website at www.annualcreditreport.com.

**How do I add a Security Freeze to my file?**

Answers to all of your questions regarding placing a state legislated security freeze on your credit file can be found via our Equifax website. Please visit our website at www.equifax.com

This link will lead you to a page that is not screen-readable at this time.

**How do I contact the Federal Trade Commission (FTC)?**

Federal Trade Commission
Consumer Response Center
Room 130
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580
www.ftc.gov

**How do I request a credit file by mail for a child under 13 years of age?**

Equifax does not knowingly maintain credit files on minor children. If you suspect that your minor child's information has been used fraudulently, you should contact the credit reporting agencies directly and report the illegal use of your child's information to law enforcement. Please supply each credit reporting agency with your child's complete name, address, date of birth and a copy of the minor child's birth certificate and social security card. Additionally, please provide a copy of your driver's license or other government-issued proof of your identity, which includes your current address, and a current utility bill containing your current address so the credit reporting agencies may promptly respond to your request. The addresses for the credit reporting agencies are listed below:

Equifax
P.O. Box 740256

Atlanta, Georgia 30374

Experian
P.O. Box 9532
Allen, Texas 75013

TransUnion
P.O. Box 6790
Fullerton, CA 92834

## Security Questions

**How secure is my information?**

Equifax recognizes the importance of secure online transactions, and takes steps to safeguard the privacy of information you provide online. The site"s security protocols and measures are designed to protect the personally identifiable information you provide from unauthorized access or alteration. These measures include physical, electronic, procedural safeguards, and encryption designed to guard your personal information.

To help ensure the privacy and protection of your personal information, it is recommended that you do not access the Equifax Free and Discounted Disclosures site through links from unfamiliar websites. We recommend that you access Equifax"s Free and Discounted Disclosures site directly at www.equifax.com/fcra.

**Is it safe to provide my Social Security number to Equifax"s Free and Discounted Disclosures site?**

The site's security protocols and measures are designed to protect the personally identifiable information you provide from unauthorized access or alteration. As an added security measure, you can choose to have your credit file display no more than the last four digits of your Social Security number. You must enter your Social Security number to receive a credit file through Equifax"s Free and Discounted Disclosures site.

**See answer to "How secure is my information?" above for more information.**

**How does the online authentication process work?**

To assure that your Equifax credit file is disclosed only to you, Equifax will authenticate your identity utilizing the personal identification information you provide on this site, including, but not limited to, your Social Security number, and then require that you answer certain questions. For your protection, if your identity cannot be authenticated for online delivery of your credit file, you will receive further instructions on how to request your Equifax credit file for delivery by the U.S. Postal Service.

**What is a cookie?**

A cookie is a piece of text information that a web server may transfer to the hard drive of your computer through your web browser when you visit a web site. Cookies are commonly used on web sites to improve your experience and to enable systems to recognize your browser. Some cookies last only through a single visit (session cookie); other may have an expiration date; still others may remain on your computer until you delete them (persistent cookie). Only the information that you provide, or the choices you make while visiting a web site can be stored in a cookie. For example, the web site cannot determine your e-mail address unless you choose to type it.

**How are cookies used on this website?**

Equifax uses session and persistent cookie technology for several purposes. For example, cookies:

- Allow you to order more than once during a visit without your having to re-enter your information each time you place an order for a Personal Solutions product;
- Allow us to gather aggregated statistical data about the use of our website for research purposes;
- Help us improve your navigation of our web site(s);
- Enable us to store your preferences for certain kinds of information and marketing offers;
- Help us to provide features such as personalized greetings;
- If you"re a Member of Personal Solutions, allow us to store your user name and encrypted customer identification number so that we recognize you when you return to our web site;
- Help us combat identity theft and fraud with more reliable identity verification and authentication data.

Our cookies only collect information during your online activity at our web sites to which this privacy policy applies, and not during any of your other Internet activity. Cookies set by us or our agents are not interpreted or shared with any other third party. We may combine cookie data with personally identifiable information or business organization-identifiable information you provide to us (e.g., your e-mail address) so that you may receive marketing offers likely to be of interest to you. Of course, you may opt out of receiving these offers at any time by following the instructions in

the marketing offer. We may sometimes use outside technology companies to set cookies on our web site and collect cookie information for us. We use the cookie information collected by these companies in the same manner as stated above in this section. Those companies may not use these cookies for their own internal purposes or share the information collected with any party other than Equifax.

**How can I accept cookies?**

You can decide if and how your computer will accept a cookie by establishing your preferences in your web browser. Please understand that, if you choose to reject cookies, you may not be able to use certain of our online services or web site features. Internet Explorer is set up to allow the creation of cookies; however, you can specify that you be prompted before a web site puts a cookie on your hard disk, so you can choose to allow or disallow the cookie; or you can prevent Internet Explorer from accepting any cookies. You can specify different settings for different security zones. For example, you might want to allow web sites to create cookies if they are in your Trusted sites or Local intranet zone, prompt you before creating cookies if they are in your Internet zone and never allow cookies if they are in your restricted sites zone. Cookies and pop-ups must be enabled to access your credit file through Equifax"s Free and Discounted Disclosures site.

**How can I learn more about guarding against internet fraud and protecting my personal information?**

OnGuardOnline.gov provides practical tips from the federal government and the technology industry to help you be on guard against phishing and Internet fraud, secure your computer, and protect your personal information.

# Welcome to Equifax

## Step 1 of 3: Personal Information Check

1. Step 1: In Process
2. Step 2: To Be Done
3. Step 3: To Be Done

**View a New or Recently Requested Credit File**

If you've been denied credit, insurance, change in credit limit, or other benefits within the last 60 calendar days, or you've recently placed a fraud alert on your credit file, you may use this site to request and view a free copy of your file as allowed under FCRA, state or federal legislation. (The use of this site requires that you allow popups and have cookies enabled)

### Personal Information

***Required Field**

- * First Name:
- * Last Name:
- Initial:
- Suffix:
- * Date of Birth: 01 01
- * Social Security Number (encrypted for your protection)
- * Would you like the first 5 digits of your Social Security Number masked in your credit file disclosure?: Yes No
- * Current Address:
- * City:
- * State: AA
- * ZIP:
- * E-Mail Address: * Please re-enter e-mail address:

### Reason for Credit File Request

Click here to view information regarding your state's guidelines for receiving free or reduced-fee access to a copy of your credit file.

- ○ Free Fraud Alert Credit File (not denied)
- ○ Free State Credit File (not denied)
- ○ Denied Credit, Insurance, Change in Credit Limit or Other Benefit
- ○ Unemployed Free Credit File (not denied)
- ○ Receiving Public Welfare Assistance Free Credit File (not denied)
- ○ Reduced-Fee State Credit File (not denied)
- ○ Believe You May Be a Victim of Fraud Free Credit File (not denied)

**You may also request a copy of your credit score.**

○ **Include Credit Score for $7.95**

○ **Include Score Watch monitoring with two in depth FICO® score reports just $7.95 per month**

## Privacy and Security Notices

We understand your desire to know how your information will be used. See our Privacy and Security Notices for complete description on how we collect, use and maintain your submitted information.

**Terms of Use**

```
EQUIFAX FREE AND DISCOUNTED DISCLOSURE REQUEST WEB SITE TERMS OF USE

SERVICE AGREEMENT TERMS OF USE - YOU MUST READ, UNDERSTAND, AND AGREE
TO THE FOLLOWING TERMS OF USE AS WELL AS THE GENERAL TERMS OF USE
```

○ **I Accept the service agreement terms of use.** ○ **I Decline**

We use SSL encryption to secure the confidentiality of your personal records. You can learn more about how we protect your information online in "Security " Notice.

- Submit

Copyright Equifax 2008 | Privacy Policy | Terms of Use | Security Policy | Disclosure Information | FAQs | FCRA

*Information Accessed from Equifax Web Site on July 23, 2008*

## Why Is My Score Not In My Report?

Your credit score is generated by information on your credit report, but is not part of the credit report itself. Your Equifax credit report is a compilation of information about you and your credit history that has been reported to Equifax by others, mostly by those who granted you credit. Your credit score, on the other hand, is a number calculated using the information in your credit report. The score projects the amount of risk you pose to a lender.

- Two common scoring models are the Vantage Score and the FICO® score.
- Large creditors may use a customized scoring model. For example, car dealers may use a scoring model that focuses on car payment history.
- When lenders request your credit report, they often choose to receive a credit score at the same time, and will select which scoring model they want to use.

When you receive your yearly, free FACT Act credit report disclosure from Equifax you have the option of purchasing disclosure of your FICO® credit score OR

Get Score Power®, which provides your FICO® score along with a detailed analysis and explanation. (Encouraged)

*Information Accessed from Equifax Web Site on July 23, 2008*

**Information from Equifax web site.**

How is a credit score determined?

A credit score is based on information contained in your credit file. The FICO® score is calculated using the following credit file items:

- **Payment history**: Approximately 35% of the FICO score is based on this category.
- **Amounts owed**: Approximately 30% of the FICO score is based on this category.
- **Length of credit history**: Approximately 15% of the FICO score is based on this category.
- **New credit**: Approximately 10% of the FICO score is based on this category.
- **Type of credit used**: Approximately 10% of the FICO score is based on this category.

Please keep in mind that there are many different scoring models that can be used to calculate a credit score, and each scoring model may give more or less weight to the various items of information in your credit file.

What factors impact my credit score?

**Doing the following typically has a positive impact on your credit score:**

- Paying your bills on time. Delinquent payments and collections can have a significantly negative impact on your score.
- If you have missed payments in the past, getting current and staying current on your payments.
- Paying off debt rather than move it around.
- Re-establishing your credit worthiness if you have had problems. Opening new accounts responsibly and paying them off on time may help in the long run.
- Applying for and opening new credit accounts only as needed.
- Keeping credit cards and managing them responsibly. In general, having credit cards and installment loans (and making timely payments) may help in the long run. Someone with no credit cards, for example, may be seen as a higher risk than someone who has demonstrated a history of managing credit cards responsibly.
- If you are having trouble making ends meet, contacting your creditors or seeing a legitimate, reputable credit counselor.
- Keeping balances low on credit cards and other lines of revolving credit.
- Doing your rate shopping for a loan or credit line within a short period of time. FICO® scores distinguish between a search for a single loan and a search for many new credit lines in part by the length of time over which inquiries occur.

*Information Accessed from Equifax Web Site on July 23, 2008*

**The following factors typically do not have a positive impact (or may even have a negative impact) on your credit score:**

- Opening a number of new credit cards that you do not need, just to increase your available credit. This approach could backfire and actually have a negative impact on your score.
- Opening a lot of new accounts in a short period of time, especially if you have been managing credit for a short time. New accounts will lower your average account age. If you do not have a lot of other information in your credit file, this could have a larger effect on your score. Also, rapid account build-up can look risky if you are a new credit user.

What is a "good" credit score?

FICO® scores can range from 300 to 850, but the majority of scores usually fall within the 600s and 700s:

- 20% are above 780
- 20% are in the range of 745 - 780
- 20% are in the range of 690 - 745
- 20% are in the range of 620 - 690
- 20% are below 619

Since there is no universal score cutoff used by all lenders, it is hard to say what a good score is outside the context of a particular lending decision. For example, one lender may determine that a score of 750 may qualify you for a platinum credit card, whereas a score of 675 may indicate that you are a better match for a standard card.

Why is my Equifax score different from my Experian and TransUnion credit scores?

There are several reasons for variations in your credit score among the different credit reporting agencies and even among different credit grantors:

- First, your credit score from each credit reporting agency is based on the information in your credit file at the credit reporting agency, and the credit history information each credit reporting agency has about you can differ. This can result in your score at the other credit reporting agencies being different from your Equifax score.
- Second, there is a slightly different FICO credit scoring model at each of the three nationwide credit reporting agencies due to the differences in credit history information they each have about you. Remember: your FICO score at a given credit reporting agency is only based on the credit data that credit reporting agency has about you.
- Third, although the FICO® credit scoring model is the score used most often by lenders, each of the credit reporting agencies, including Equifax, has their own scoring models. These other models may evaluate your credit file differently from the FICO® model and, in some cases a higher score may mean more risk, not less risk as with FICO® scores.

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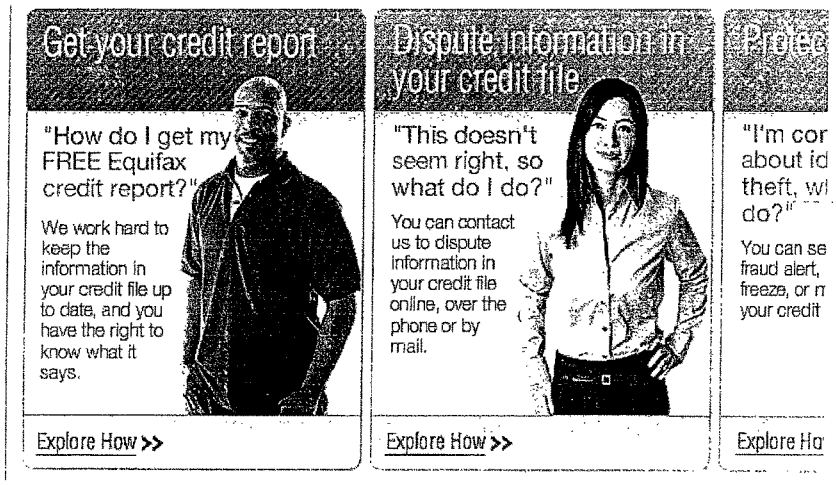


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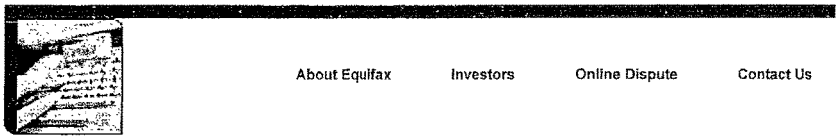

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## Understanding Credit Scores

Print this page

Looking for the ability to improve your attractiveness to lenders by improving your credit score? There's good reason to do so -- a higher score can provide you a greater array of financial options and more favorable credit offers. Even if you already have a good score, there's always room for improving your creditworthiness by understanding your credit score. Keep in mind, however, that your credit score is based on your history of borrowing and repaying money, so there's no way to instantly change it. But here are some effective strategies that can help to strengthen your creditworthiness over time.

### Top 10 Strategies That May Help You

**10.** Learn what your current FICO® credit score is and what appears on your credit report. Score Power® gives you immediate access to your Equifax Credit Report and includes your current FICO® credit score.

**9.** Don't open new credit cards that you don't need just to increase your available credit. This approach could backfire and actually lower your score.

**8.** Try to keep your total account balances as low as possible. High outstanding debt may negatively affect your score, as you have a greater chance of missing payments.

**7.** Correct any incorrect information that might appear on your credit report. Visit Disputing Information on Your Report for more information.

**6.** If your credit is severely damaged, or you have a very short credit history, there are still ways to improve your creditworthiness over time. Consider opening new accounts responsibly and paying them off on time.

**5.** If you fall behind on paying a bill because of illness, unemployment, or family issues, write a short explanation to the credit reporting agencies. They will add it to your credit report. Also, call your creditor to explain the circumstances and, if possible, work out a payment schedule you can meet.

**4.** If you need help managing your credit, contact a reliable nonprofit agency, such as:
Consumer Credit Counseling Service (CCCS)
800-388-2227
www.cccsintl.org

**3.** To minimize the number of inquiries on your credit report, don't apply for multiple credit cards over a short period of time, or for a card you're not likely to get. Apply for new credit accounts only as needed.

**2.** Make all of your payments on time. If forced to miss a payment, be sure to pay the missed payment the following month along with the current payment. Accounts more that are past due will be indicated on your credit report. If you have missed payments, get current and stay current. As a general rule, the longer you pay your bills on time, the better your score.

**And the number one way...?**

**1.** Continue to check your credit report regularly, charting your progress along the way. Get your FICO® score and your Equifax Credit Report today with Score Power®!

PRIVACY TIMES

EDITOR: EVAN HENDRICKS

**Testimony of**

Evan Hendricks, Editor/Publisher
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Credit Scores & Credit Reports:
How The System Really Works, What You Can Do
www.CreditScoresandCreditReports.com

"What Borrowers Need to Know About
Credit Scoring Models and Credit Scores"

Before The House Financial Services Committee
Subcommittee on Oversight and Investigations
July 29, 2008

Mr. Chairman, and Members of the Subcommittee, thank you for the opportunity to testify before the Subcommittee. My name is Evan Hendricks, Editor & Publisher of *Privacy Times*, a Washington newsletter since 1981. For the past 31 years, I have studied, reported on and published on a wide range of privacy issues, including credit, medical, employment, Internet, communications and government records. I have authored books about privacy and the Freedom of Information Act. I have served as an expert witness in litigation, and as an expert consultant for government agencies and corporations.

I am the author of the book, "Credit Scores and Credit Reports: How The System Really Works, What You Can Do." (3rd Edition, Privacy Times 2007)

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**Credit Scores & American Consumers: Only Half Way There**

This is a very important hearing, as it highlights how far we have come on the issue of credit scores, while at the same time underscoring how far we have to go.

The bottom line is that consumers cannot obtain, prior to applying for credit, the actual credit scores that lenders use to judge them. This is because the three major credit reporting agencies (CRAs) use contracts to prohibit resellers from providing consumers with their "tri-merge reports," the version of credit reports sold to lenders. Tri-merge reports and other creditor-version reports, and the credit scores associated them, are truly where the "rubber meets the road," for American consumers. They remain the "secret sauce" that consumers may not access. Congress can and should change this.

Moreover, the proliferation and sale of credit scores not used by lenders can cause confusion and even mislead consumers in a manner that is patently unfair. At a minimum, Congress can and should provide for greater transparency and fairness.

Accordingly, Congress needs to act to bring the appropriate level of transparency and fairness to credit scoring. In addition, the area of "alternative data" is an important and complex field that requires careful weighing of a myriad of factors. While I applaud the Subcommittee for exploring this area, I would urge it to proceed with caution. Similarly, I would urge caution on another issue before the Committee – amending the law in regards to credit monitoring. This too is a complex area and I fear the current proposals are designed to give undeserved breaks to the credit reporting industry, while at the same time, not advancing consumer protection.

**Credit Score: A History of Secrecy**

When use of credit scores first became widespread in the mid-1990s, they were completely secret. First, lenders did not inform consumers that credit scores existed or that they were using them. Despite their importance consumers were not told how they were calculated or who was using them.

When people began learning that credit scores existed, and would ask to see them, lenders and the credit reporting agencies (CRAs) refused to provide them.[1]

In fact, the Federal Trade Commission (FTC) put out an opinion stating that federal law did not require the credit bureaus to reveal credit scores to consumers who requested their credit reports. This was in part, because the 1996 revisions to the Fair Credit Reporting Act (FCRA) specified disclosure was not required of "any information concerning credit scores or any other risk scores or predictors relating to the consumer."[2]

Public criticism of this policy mounted as the vital role of credit scores in credit and insurance decision-making became evident. The changing environment was best illustrated by a

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[1] One of the first to report on credit scores and their importance was Michelle Singletary of the *Washington Post* in the mid-1990s.
[2] 15 U.S.C. Sect. 1681g(a)(1)

situation that arose in February 2000 at E-Loan, an Internet lender that could quickly approve mortgage and auto loans, in part because credit scores facilitated automated decision-making. To better advise consumers where they stood, E-Loan decided to tell prospective loan applicants their FICO scores—a radical move at the time. Within a month, thousands of people took advantage of the service.[3]

But the move sparked an uproar in the credit industry, as two of the three national credit reporting agencies (CRAs) moved to cut off E-Loan's use of credit scores. E-Loan ultimately prevailed when California passed a state law, sponsored by State Senator Liz Figueroa, requiring lenders to provide California mortgage and home equity applicants with the score used in their loan decision. The law also required Equifax, Experian and Trans Union to disclose credit scores to consumers who requested them.

"The passage of this law is a giant step forward for California consumers, but there's still more that needs to be done," said Chris Larsen, E-Loan's Chairman and CEO. "This is information that should be readily and freely available to consumers nationwide. There should be very little difference between getting information about a stock or mutual fund and finding out your credit score. Just like consumers can research an investment before they commit their money to it, consumers should have free access to information about their credit score *before* they apply for a loan."[4]

**FACT Act: Another Step Forward**

In 2003, Congress took a major step forward in fulfilling Larsen's plea.

The Amendments to the FCRA, known as the FACT Act, require credit bureaus, for a "fair and reasonable" fee, to disclose to consumers their credit scores and how those scores are determined. Moreover, the Act for the first time required mortgage lenders and brokers to provide scores that were pulled in connection with their mortgage or re-financing applications. This was important because the CRAs by contract prohibited lenders from giving consumers the actual scores by which they were being judged.

However, the FACT Act does not require CRAs to provide consumers with the scores that lenders *actually use*. Instead, CRAs can disclose "educational scores," meaning FICO "knock-offs" or "FAKOs," that approximate scores used by lenders, but which can differ significantly.

This means that a consumer, who is trying to be diligent and find out what his or her credit score is before applying for credit, will pay for a "FAKO" score that might be higher than the one ultimately pulled by the lender. When the consumer applies for credit, she learns that she was not as creditworthy as she thought, and doesn't qualify for the interest rate she expected. We have heard of several such anecdotal cases.

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[3] E-Loan Opens Over 10,000 Personalized Loan Management Accounts In First Month," E-Loan Press Release, March 23, 2000

[4] E-LOAN, Inc., A Full Credit Score Disclosure Pioneer,
Calls For National Legislation," E-Loan Press Release, June 27, 2001

Two of the major CRAs – Experian and TransUnion – prominently push their own knock-off scores – the Experian Plus score and the TU TrueCredit score. The Plus score is also pushed at the notorious FreeCreditReport.com, which is run by Experian subsidiary ConsumerInfo.com. While the traditional FICO score on which consumers are judged uses a range of 350-850, TrueCredit Score uses a different range, going up to 950. Neither Experian nor TransUnion prominently inform consumers that the scores they are selling are not used by lenders and may differ significantly from the FICO scores used by lenders.[5]

To top it off, the three CRAs joined forces to create the "VantageScore," which features a range of 501 to 990. Although it was unveiled with great fanfare in March 2006, it does not appear that VantageScore has achieved significant market penetration. However, it has added to the confusion that uninitiated consumers experience when they try to understand what their actual score is.

At a minimum, fundamental fairness dictates that sellers of knock-off scores clearly and conspicuously disclose that their scores are not used by lenders and may differ significantly from the ones that are.

**Epitome of Unfairness: No Consumer Access To Actual Credit Scores**

Consumers can purchase their FICO scores through Equifax or through Fair Isaac's Web site, www.myfico.com. These are likely to be the closest to the actual scores pulled by lenders when the consumer applies for credit. Moreover, knowledgeable consumers who know to ask can obtain, after-the-fact, their actual FICO scores that were pulled by lenders – thanks to the FACT Act Amendments.

However, consumers, prior to a major credit application, still cannot even purchase the actual scores that lenders pull.

Why? It is an artificial barrier unilaterally imposed by the three CRAs through their contracts with "resellers," i.e., which include the small, independent credit bureaus that compile "tri-merge" reports for the mortgage industry. Tri-merge reports are the "subscriber" (i.e., creditor) versions of the credit report. They can have more information because the CRAs attempt to include in them the maximum possible information that *might* relate to the consumer – in essence, so no negative item is missed. Thus, Tri-merge reports and "subscriber" versions of

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[5] In its terms and conditions, Experian and its subsidiary ConsumerInfo.com, which runs FreeCreditReport.com, states, "The PLUS Score(R), developed by Experian, and the different risk levels presented by it, are for educational use only. The PLUS Score(R) is not currently sold to lenders, and is not an endorsement or guarantee of your credit worthiness as seen by lenders.

Please be aware that there are many scoring models used in the marketplace. Each scoring model may have its own set of factors and scale. The information and credit scoring model may be different than that used by a lender. The PLUS Score(R) may not be identical in every respect to any other credit score produced by another company or used by your lender. The PLUS Score(R) is not a so-called FICO score, and may differ for a variety of reasons."

credit reports are the "secret sauce" to which consumers still do not have access in advance of applying for credit.

This is unconscionable, in my opinion. Congress should make it illegal for CRAs to prohibit by contract or any other means the sale or purchase of tri-merge reports or subscriber versions, and the actual credit scores associated with them. This is not only patently unfair to consumers, it is an unacceptable barrier to commerce. Not only would some educated consumers be interested in buying their actual scores, but enterprising companies that base their business model on serving as the consumer's advocate would also greatly expand the market.

It is important to understand that even if a consumer buys his FICO score, it could differ significantly from the FICO score pulled by the lender.

This is because the CRAs use "partial matching" algorithms in determining what information to sell to lenders, but use more exact matching of identifiers when determining what information to include on a report disclosed directly to a requesting consumer.

The following passage from my book, Credit Scores & Credit Reports: How The System Really Works, What You Can Do, helps explain:

> The three CRAs each store this information in their own massive database. The CRA databases include data on virtually all American adult users of credit—an estimated 205 million people.[6]
>
> A credit report is not fully assembled until the CRAs have a reason to assemble one. For instance, when a consumer applies for credit, the credit grantor or "subscriber" relays to the CRA identifying data from the consumer's credit application, at a minimum, name and address, often the SSN, and sometimes date of birth. (It's worth noting that the CRA can return a credit report to the credit grantor without an SSN.)
>
> This is when the key moment occurs. Applying this identifying or "indicative" data, the CRA's algorithm then decides which information in the database relates to or "matches" that consumer, and then "returns" to the credit grantor (subscriber) a consumer credit report consisting of this information. Thus, it is the algorithm, or "business rule," that decides which data go into your credit report.
>
> **The Search Logic/Algorithm**
>
> In the Matthew Kirkpatrick trial cited in the previous chapter, Equifax Vice President Phyllis Dorman said that when "building a file" after receiving data from a creditor, or when deciding what data to include on a credit report that will be disclosed to the creditor, the first factor considered by the Equifax system is geographic region.

[6] www.experian.com/small_business/knowledge.html, visited 9/14/07.

Then its "matching algorithm," known as L90, relies on 13 matching elements. Two of the elements that constitute a distinct category are: (1) exact Social Security number (SSN) and (2) partial SSN (meaning that most, but not all digits are the same).[7]

The remaining elements are (3) last name, (4) first name, (5) middle name, (6) suffix, (7) age, (8) gender, (9) street number, (10) street name, [8] (11) apartment number, (12) City, state and zip, and (13) trade account number.

There is a very important difference in how the system works when you ask to see a copy of your own credit report as opposed to how it works when a subscriber asks the CRA for your credit report. One reason for this is that the CRAs have a duty to ensure that they do not give your credit report to anyone who does not have a permissible purpose to see it—particularly someone who is trying to impersonate you or otherwise do you harm. Accordingly, when you ask for your own report, you are required to give extensive identifying information to authenticate yourself—to prove that you are really you. This also enables the CRA's algorithm to more concisely assign the proper accounts to your credit report.

However, it can be a very different story when a credit grantor or other subscriber asks for your credit report. For starters, the setting is different. To have instant access to credit reports, subscribers must sign contracts pledging to only use credit reports for permissible purposes, to abide by other restrictions, and comply with the FCRA. CRAs look at their subscribers as members of a trusted circle who know and play by the rules.

More importantly, the priorities are different. Since the subscriber is buying the credit report in order to decide whether or not to grant you credit, the CRA wants to ensure that it does not leave out anything that *could* be relevant to that decision. After all, if the CRA failed to include evidence of late payments in your credit report, and you default, the credit grantor is going to blame the CRA. Another factor is the credit grantor might only have limited information about the consumer, like name and address, and no SSN, or its employee might have written down the SSN incorrectly. Therefore, the CRA seeks to maximize disclosure of any *possible* information that might relate to the consumer about whom a subscriber inquires. This becomes trickier when the CRA conducts the search based upon very limited, or even imperfect, identification information.

To accomplish this, the CRAs' algorithms are designed to accommodate such errors as transposed digits within SSNs, misspellings, nick names, and changed last names (women who marry), and different addresses (people who move), by accepting "partial matches" of SSNs and first names, and in some circumstances, assigning less importance to last names.

Thus, while you must provide an exact match of your SSN to obtain your own credit report, a subscriber can still obtain your credit report even if there is a

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[7] Testimony of Phyllis Dorman, Matthew Kirkpatrick v. Equifax Credit Information Services, U.S. Dist. Ct., Oregon, CV-02-1197-MO; 1/20/05

[8] Some algorithms may only use the first 4-to-6 characters of the number-address field, which would mean that "123 Main Street" would match "123 Mainwright Street."

match of only seven of the nine digits in your SSN. What's more: if the SSN on the credit application exactly matches yours, the CRAs' algorithms often will tolerate major discrepancies in last name, street address, city, and state.

Accordingly, it's quite possible that the "subscriber" credit report sent to the company holding your credit application will have more data than the credit report you obtained directly from the credit bureau. There have been occasions when a subscriber will reject an application for credit based on information in a credit report, but when the consumer gets her own report, the information isn't there. It was only in the subscriber report.

[*End of book passage.*]

**Alternative Data**

There continue to be quality studies about the use of alternative data – mainly from utilities and telephone companies – in credit reporting and scoring. I am familiar and somewhat sympathetic to the arguments that an expansion of credit reporting by utilities and phone companies would benefit significant sectors of the population, particularly those that do not participate in mainstream credit.

However, a word of caution. Because of decades of practice, there is an expectation that utilities and phone companies do not report data to CRAs (except seriously derogatory data in some circumstances). Accordingly, I see serious problems with making people aware that a fundamental change had occurred and that their data would be regularly reported. One cause for concern is that people who are generally responsible but occasionally late could suffer significant blows to their creditworthiness, without realizing that such a blow was possible. The harm would be greatest to the very "thin-file" populations that alternative reporting was supposed to help because one derogatory item would have a greater negative impact on a thin file versus a full file.

Moreover, the systematic reporting of data like utilities', which traditionally has not been reported, has implications for privacy that should be carefully weighed.

That is why if there is to be movement in this area, I favor an opt-in approach. My understanding is that such an approach is embodied in the proposed legislation (CA AB 588) introduced by California Assistant Assembly Majority Leader Kevin de León (D-Los Angeles) that would to allow consumers to authorize utility payment information to be incorporated into consumers' credit profiles."

**Credit Monitoring Legislation**

The Committee in May held a hearing on "Legislative Proposals to Address Credit Monitoring Services." I would urge caution on this issue. This too is a complex area and I fear the current proposals are designed to give undeserved breaks to the credit reporting industry, while at the same time, not advancing consumer protection.

Mr. Chairman, thank you again for this opportunity. I would be happy to answer any questions.

# STATEMENT OF

# STAN OLIAI

# SENIOR VICE PRESENT OF DECISION SCIENCES

# EXPERIAN DECISION ANALYTICS

**Before the**

**Committee on Financial Services**

**Subcommittee on Oversight and Investigations**

**U.S. House of Representatives**

**On**

**"What Borrowers Need to Know about Credit Scoring Models and Credit Scores"**

**July 29, 2008**

**I. Introduction**

Good afternoon Chairman Watt, Ranking Member Miller and Members of the Subcommittee. My name is Stan Oliai, and I am Senior Vice President of Decision Sciences for Experian Decision Analytics. I'd like to thank the Committee for the opportunity to testify here today and provide information that will describe how credit scores are developed and used. I will summarize the longer statement that I have submitted for the record.

I'd like to start with a brief background about Experian. With our North American headquarters in Costa Mesa, California, Experian currently operates in 65 countries with more than 15,000 employees worldwide. Experian is well known in the United States as one of the three national credit reporting agencies. However, Experian is also a global leader in providing information, analytical tools and marketing services to organizations and consumers to help manage the risk and reward of commercial and financial services. My business unit, Decision Analytics, serves as one of the world's largest providers of software for credit scoring, fraud detection and risk-based pricing.

Most lenders use a credit score to estimate the relative risk that a consumer presents in repayment of a loan and use the score as part of a process to price the product accordingly. The use of scores for risk-based pricing has led to significant increases in efficiencies in the market that provides tremendous benefit to both businesses and consumers. Some of the tangible consumer benefits include less cross-subsidization of risk, lower prices, more available capital and real-time lending decisions. Yet despite these benefits, the process is often not fully understood or appreciated.

**II. The Role of Credit Reporting Agencies in the Lending Decision Process.**

There is often confusion surrounding the role of the credit reporting agency in the lending process. It is worth clarifying one key fact: credit reporting agencies do not make lending decisions; only lenders can do that. Therefore, respectfully, I must say that it is unfortunate that a lender is not part of the today's panel, because only a lender can testify as to how a score is used in the loan underwriting process. You will learn from my testimony that neither companies that develop credit scores nor credit reporting agencies that deliver information to scoring models participate in actual lending decisions. We simply are not in a position to testify as to how scores are weighted or what other information besides a score is considered when a lending decision is made.

Credit reporting agencies do provide credit reports and can generate a credit score at the request of the lender from a model chosen by a lender. These credit scores help lenders make lending decisions. However, credit scores are not the only piece of information upon which lending decisions are made. Each lender has its own proprietary underwriting process and uses information from multiple internal and external sources when making a lending decision. A credit score is only one tool that a lender uses in deciding whether to extend a loan to a consumer. The volume of information sought would depend on many factors, from the type of loan being offered (i.e. small business loan vs. mortgage) to the type of collateral for the loan (i.e. year and model for an auto loan vs. similar sales records for real property). A credit score alone in any of these situations would not and should not be the sole determining factor for the extension of the

loan, but would be balanced against other information included in the consumer's application or obtained by the lender.

**III. What Are Credit Scores and how are they Calculated?**

A credit score is simply a numerical expression of risk of default produced by a mathematical formula or model. A credit score formula is created based on a statistical analysis of a large, representative sample of historical credit files. There are numerous credit models in use today.

A credit score predicts the relative likelihood that the person will pay his debts in a timely manner. Information used in calculating a credit score comes from an individual's credit file and generally includes credit account history (was the account paid, was it paid on time, how long has the account been open, what is the outstanding balance, etc.), type of account (revolving, installment, mortgage, etc.), public record information (liens, judgments, bankruptcies) as well as those inquiries in the credit file that represent applications for new credit or other consumer-initiated transactions. A credit file does not include information such as income or assets, and does not include demographic information such as race or ethnicity, and those factors are not used in credit risk scores.

It bears noting that a number of other factors, not reflected in a credit report or credit score, go into the underwriting process, such as income, collateral value, debt to income ratios and the like. Each lender decides its own risk tolerance. Many consumers might think they only have three possible credit scores: one from Experian, one from Equifax and one from TransUnion. In fact, a consumer could have many different scores, depending on the lender. Each lender can develop its own in-house "custom" score or

select a model developed by a third party, such as Experian, that reflects the individual lender's own level of risk tolerance and control for different risk factors. There are many vendors offering different scoring models aimed at different types of risk. For example, one lender's risk model may see one 60-day late payment as acceptable, while another would not. Or, another lender may acquire a third-party score aimed at determining whether a person is likely to be progressing toward bankruptcy.

Experian and other model developers design credit score models that are "empirically derived, demonstrably and statistically sound," as required by Regulation B. Regulatory oversight of credit scores is accomplished through routine bank examinations for compliance with a number of laws that govern fair lending, such as the Equal Credit Opportunity Act. This makes sense, because a credit score is a model chosen by a lender to assist in its proprietary underwriting process. The lender is ultimately responsible for demonstrating to regulators that the scoring model it has chosen to use complies with lending laws.

**IV. How Consumers Can Obtain a Credit Score and Maintain a Good Score**

A consumer can obtain a free disclosure of the credit report from www.annualcreditreport.com. While obtaining an Experian credit report through that website -- or at any time through www.experian.com -- a consumer can obtain their VantageScore for $5.95. This price has not changed since the enactment of FACTA. Since Experian believes it is in the consumer's best interest to acquire the credit report and score at the same time, we offer a combined package for $15. This way, consumers are able to better understand how the score and accompanying reason codes actually relate to the data in the credit report.

The Committee has asked about the total number of scores and consumer disclosures Experian has made to consumers since the FACT Act was enacted. We are pleased to provide an aggregate of those numbers to the Committee through our trade association -- the Consumer Data Industry Association or CDIA -- just as soon as possible.

One of the greatest misconceptions regarding credit scores is that there are fast and easy tricks a consumer can take to improving a score. This is simply not the case. This misinformation is typically perpetuated by credit repair clinics and other similar organizations. Some of these "tricks" include: closing unused credit accounts, becoming an "authorized user" on another's credit card, and disputing accurate information in the hopes of getting it removed.

While misleading information abounds, the truth is that a bad credit score derived from a credit report with accurate but derogatory information cannot be cleaned-up overnight, despite promises to the contrary. A bad credit score was not created overnight and it cannot be quickly "fixed" with a few simple changes. Improving one's credit score requires time and diligence in changing one's credit behaviors. While these changes are simple in theory, the application can often prove challenging. Simply put, the best way to "fix" one's credit score involves paying bills on time and keeping the debt to available credit ratio low.

Attempts by consumers to use some of these tricks can create secondary issues for the consumers. For example, I know the subcommittee is interested in how authorized user tradelines are treated in scoring models. For background, an authorized user on a credit account has the account holder's permission to charge to that account, but is not

liable to the lender for payment of those charges. This is different than the situation of a joint account where multiple users are each liable for the account. Reg. B under the Equal Credit Opportunity Act requires lenders to report these authorized user and joint accounts that are designated to reflect the participation of both spouses in a manner that allows the reporting of data in both names.

Lenders also may (and do) report all authorized user and joint accounts. These include accounts shared among other family members, siblings, friends, roommates, etc. In many instances, lenders are prohibited from asking whether an authorized user account is held with a spouse. In these situations, a credit report only reflects that an individual is an authorized user of an account, not the relationship (spousal or otherwise) with the account holder.

Offers abound on the Internet to improve a consumer's credit by adding that consumer (for an exorbitant charge) as an authorized user on the credit account of a complete stranger. The account is in good standing, and the consumer added as an authorized user never gets access to the account. Presumably the goal of such offerings is for individuals with bad credit to benefit from others with better credit scores. In many scoring models, this practice will have the effect of increasing the consumer's credit score. Depending on other factors in the consumer's report, this could result in the consumer qualifying for a loan or a rate on a loan for which they would otherwise have not qualified.

We should label the practice I have just described as what it is: **fraud**. In order to prevent this fraud, some model developers do not consider authorized user accounts. VantageScore is one of those models. Because Reg. B only requires lenders to use data

on spousal authorized user accounts if it is available to them, such models are in compliance with Reg. B. The underlying credit reports on which the scores are based do not (and should not) report which of these accounts are held by spouses, because this data is simply not reported to consumer reporting agencies by lenders.

**V. Benefits of Credit Scoring**

Credit scores provide a measurable benefit for consumers and a marked improvement over the old process that required every consumer to be subject to a manual review and judgmental decisions. A credit score is calculated strictly based on the information in the credit file, limiting potential subjectivity on the part of a lender. Credit scores promote consistency in decisions, as the same formula is applied evenly to every consumer's credit file. In fact, for this reason, automated credit scoring leaves much less opportunity for discrimination than a potentially subjective assessment by a lender. Credit scores are blind to the factors protected by the Equal Credit Opportunity Act, which include race, color, religion, national origin, sex, marital status, or age.

Credit scores also have other benefits for consumers. Scores allow for lending decisions to be made accurately, efficiently and in a time frame convenient for consumers. For example, while consumers may not realize it, credit scores allow for quick decision-making in the purchase of a new automobile. When a consumer goes into a dealership, they can drive off the lot with a new or used car even though they do not know anyone at the dealership. Because of automated credit scoring, the bank could pre-approve the consumer quickly for a loan amount before they even enter the dealership. Alternatively, the dealership could also approve the consumer for financing that afternoon.

**VI. Alternative Data and Credit Scores**

Another issue I would like to address is that of alternative data and credit scores. Questions have been raised by policymakers, consumers and lenders as to what could be done to help more low-income groups and recent immigrants develop a credit history allowing access to credit, financing and mortgages. Many lower-income Americans either do not have access to or choose not to utilize traditional lenders that report information to the credit reporting agencies. As a result, credit reporting agencies are not able to produce a credit score for these consumers that would help them in transitioning to using more traditional lenders. One solution Experian is pursuing is to work with "alternative" credit data sources, specifically utilities and telecommunications providers. These alternative sources of data can provide information that is reliable in a similar way as traditional credit history data in evaluating risks to lenders. For example, indicators that show that individuals pay monthly utility bills on a timely basis can be used to develop reliable scores that may provide lenders with information they previously did not have, but is sufficient to assess the risk of a loan.

While there could potentially be many different sources for alternative credit data, utilities and telecommunications are generally a form of credit services utilized by almost all consumers and therefore are a potentially very important source of information. A recent study by the PERC (Political and Economic Research) Council found that fully reporting energy utility and telecommunications customer payment data to consumer reporting agencies would help up to 70 million Americans gain access to affordable mainstream sources of credit.

It would be immensely beneficial to consumer reporting agencies, potential alternative credit data furnishers, low-income consumers and lenders if Congress clearly encouraged or endorsed the use of such data for these important uses.

**VIII. Conclusion**

I hope that my testimony today helped to dispel many of the myths surrounding credit scores. Credit scores remain one of the great advancements in consumer lending, and represent enormous opportunity for both consumers and lenders. Experian works hard to ensure that we have the most accurate and up-to-date credit information possible. We do this so that consumers are assured that their credit scores will serve as a useful tool in helping them to obtain the credit they need and deserve. Credit scores remain one of the best and most efficient ways of assessing a consumer's credit habits, and I hope that my testimony today will help the Committee to consider the importance of credit scores to the lending process.

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WRITTEN STATEMENT OF FAIR ISAAC CORPORATION

CREDIT SCORING MODELS AND CREDIT SCORES

BEFORE THE U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

WASHINGTON, D.C.
JULY 29, 2008

**Introduction.** Mr. Chairman and members of the subcommittee, my name is Tom Quinn. I am the Vice President of Global Scoring Solutions for Fair Isaac Corporation. Thank you for the opportunity to testify before you today regarding consumer education issues involving credit scores and credit scoring models, including: (1) use of credit scores in underwriting, (2) development of credit score models, and (3) consumer access to credit scores.

**Scoring Models**

Fair Isaac Corporation is the leading provider of analytics and decision management technology. Founded in 1956, Fair Isaac has customers in more than sixty countries who use our analytic models and technology to make credit available to people, to reduce fraud and credit losses, and to make smarter decisions. Fair Isaac pioneered the development of statistically based credit risk evaluation systems, commonly called "credit scoring systems." Thousands of U.S. credit grantors use "FICO® scores" generated using Fair Isaac-developed scoring systems, which are implemented at the national credit reporting agencies Equifax, Experian and TransUnion LLC. Fair Isaac also has developed a version of its FICO scoring model for use by credit bureaus outside of the U.S. This model is now in use or being installed in 16 countries in Europe, Asia, the Middle East, Central and South America.

Fair Isaac created the way credit scoring systems are developed. Creating the FICO scoring model requires two samples of credit reports two years apart for the same randomly selected depersonalized set of consumers, provided by one of the national credit reporting agencies. Our analytic scientists then analyze the data in the earlier data set to isolate and prioritize factors that consistently predict the credit account performance noted two years later in the later data set. Those factors found to be most powerful and consistent in predicting credit performance, individually and in combinations, form the basis for a complex mathematical algorithm which becomes the predictive scoring model. The traditional FICO scoring model evaluates five types of data elements from consumer credit reports: 1) payment history, 2) outstanding debts, 3) length of credit history, 4) pursuit of new credit, and 5) mix of types of credit. The contribution of each type of data element to a typical consumer's FICO score is approximately: payment history (35%), outstanding debt (30%), length of credit history (15%), pursuit of new credit (10%), and mix of types of credit (10%). These factors have been published on Fair Isaac public websites since June 6, 2000. On March 19, 2001, Fair Isaac and Equifax launched the first product for consumers that contained their FICO score.

Fair Isaac has also developed custom scoring systems for hundreds of the nation's leading banks, credit card issuers, finance companies, retailers, insurance companies, and telecommunication providers. Some form of credit scoring is now used in the majority of consumer credit decisions, and the most widely used credit scores in the U.S. today are FICO scores. A FICO score is a 3-digit number within the 300-850® range that tells lenders how likely a borrower is to repay as

agreed. FICO scores use information from consumer credit reports to provide a snapshot of credit risk at a particular point in time. Scores change over time, as that credit risk prediction reflects changes in underlying behaviors and factors present on a consumer's credit report.

**Fair Isaac Works to Serve the Market's Needs**

FICO scores were first introduced to the marketplace in 1989 and have been consistently redeveloped and updated through the years to ensure their predictive strength. A redevelopment project is currently underway, called FICO® 08, which is being rolled out this summer and fall. FICO 08 has been developed with up-to-date data from the credit bureaus and incorporates our latest technical enhancements.

In addition to renewing the FICO score, Fair Isaac works to serve the marketplace with other credit-related programs and analytics. For example, Fair Isaac has recently developed a new tool to assess a consumer's ability to take on more debt given the consumer's present financial circumstances. This tool, called the **Credit Capacity Index™**, can be used by financial institutions along with the FICO Score to assess a potential borrower's ability to take on more debt. The Index identifies consumers best able to repay incremental debt, increases lenders' control over loss exposure and reserves, and facilitates responsible lending practices

Fair Isaac also pioneered the use of alternative data to assist in credit decisions for consumers with thin credit files or no credit files. Fair Isaac launched its **FICO® Expansion® Score** in August 2004, to address the estimated 30-50 million consumers for whom insufficient credit history data exists at the credit reporting agency to calculate a traditional FICO score. The FICO Expansion model evaluates nontraditional credit history information provided by specialized credit bureaus including payment performance records for purchases such as furniture bought on lay-away, verified bill payment information, membership account performance at retail vendors, and selected performance involving bank deposit accounts such as the propensity to overdraw checking accounts. The FICO Expansion score is designed to have a very similar odds-to-score ratio as the FICO score. The FICO Expansion score includes programs to assist in building credit such as one Fair Isaac announced in 2007 with Pay Rent Build Credit (PRBC). Consumers can submit bills to PRBC which are then verified and posted, thereby allowing consumers without traditional credit to establish their own credit history. A PRBC Credit Report could then be used with a FICO Expansion Score to enable lenders to assess the risk of applicants who have little or no traditional credit history.

**Authorized Users**

Since it was first introduced, the traditional FICO scoring model has calculated a score using information about any authorized user credit accounts present on the credit report available to the scoring algorithm. Fair Isaac regularly updates the FICO scoring model in a rigorous process called model redevelopment. On June 5, 2007, Fair Isaac announced that with our next model update which we called FICO 08, authorized user accounts would no longer be included in the calculation of the scores. Fair Isaac was trying to protect lenders and consumers from a new type of credit repair practice known as "piggybacking" or "tradeline renting", which has received national attention from news media since March 2007. Piggybacking is an attempt to artificially inflate consumers' FICO scores and deliberately misrepresent consumers' credit history to potential lenders, by paying consumers with good FICO scores to add strangers with poor FICO scores to their credit card accounts as authorized users.

After consulting with the Federal Reserve Board and the Federal Trade Commission earlier this year, Fair Isaac has decided to include consideration of authorized user tradelines present on the

credit report in the FICO 08 model. Our scientists have devised a method to consider these tradelines while materially reducing the negative impact that could arise from piggybacking.

**Federal Regulatory Oversight**

Fair Isaac is regulated at the federal level by the Federal Trade Commission. We have a regular, ongoing dialogue with the FTC in which we explain our products and practices. We recently trained 30 new FTC attorneys and examiners on a basic understanding of FICO scoring. In addition, in the past year, Fair Isaac has met with senior officials and provided training sessions for examiners at the Federal Reserve Board, the Office of Thrift and Supervision, the Federal Deposit Insurance Corporation, the Office of Management and Budget, the Federal Housing Administration, and the GSEs (Freddie Mac and Fannie Mae). We regularly speak with many state attorneys general and other government officials.

**Fair Isaac's Commitment to Financial Literacy**

Fair Isaac has been a pioneer in consumer education about credit scores and credit scoring models. In the past year, we have participated in consumer financial literacy forums provided by the Greater Washington Urban League, Corporation for Enterprise Development, and Brookings Institute. We were active members of President Bush's Advisory Council on Financial Literacy, the Committee on the Underserved.

On March 19, 2001, Fair Isaac launched its score explanation website for consumers, www.myFICO.com, which has become a central source of information for consumers interested in learning about credit scoring. At myFICO.com, the consumer obtains their FICO score, the underlying credit report on which it was generated as well as a detailed explanation of the score, score range, how the consumer's score compared with the scores of consumers nationally as well as primary reasons why their score was not higher. The price of Score Power was $12.95 in 2001 when first introduced and it has increased over seven years to $15.95, for an average annual rate of increase of 3.3%. Score Power was made available to consumers at both www.myFICO.com and www.Equifax.com. During the past seven years Fair Isaac has introduced additional products to help consumers monitor their credit scores and credit reports, and products that provide coaching on credit management from nationally recognized author and expert Ms. Suze Orman. www.myFICO.com is the only place where consumers can get their FICO scores calculated from Fair Isaac's scoring model at all three of the national credit reporting agencies. To date, approximately 20 million FICO scores have been delivered to consumers from www.myFICO.com, www.Equifax.com, and affiliates. By using myFICO, consumers have taken steps to control their credit lives and help improve and protect their overall financial health.

myFICO also has added abundant educational materials about credit scoring to www.myFICO.com. This includes the original list of all the credit factors that are assessed by the FICO scoring model with explanations, what information the model ignores, how consumers can take action to improve their scores over time, how to prepare for a loan, and much more. myFICO created an 18-page booklet for consumers titled "Understanding Your FICO Score" which is available through the website. myFICO also has partnered with the Consumer Federation of America on a pamphlet for consumers titled "Your Credit Scores" which has been distributed to consumers nationwide by both organizations and the Federal Citizens Information Center. This pamphlet is now being updated for re-release. Most recently, myFICO created a permanent, public online discussion group called FICO Forums for any consumers interested in discussing and comparing notes on credit scores and related subjects.

In addition, Fair Isaac is working with lenders to develop programs in which bank customers can see their current credit scores when they access their accounts electronically. This **Scores on Statements**™ program presents consenting consumers with free FICO scores monthly, along with score explanations and extensive credit management educational content via participating lenders' secure banking websites. The score-tracking feature shows consumers how responsible use of credit results in score improvements over time.

I thank you for the opportunity to share with you Fair Isaac's expertise and experience in this important area.

**United States House of Representatives**

**Committee on Financial Services**

**Subcommittee on Oversight and Investigations**

**Hearing on**
**"What Borrowers Need to Know About Credit Scoring Models and Credit Scores"**

**July 29, 2008**

**Testimony:**

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**United States House of Representatives**
**Committee on Financial Services**
**Subcommittee on Oversight and Investigations**
**Hearing on "What Borrowers Need to Know About Credit Scoring Models and Credit Scores"**
**July 29, 2008**

**Testimony of Professor Michael E. Staten**
**Director, Take Charge America Institute**
**Norton School of Family and Consumer Sciences**
**The University of Arizona**

Good afternoon Mr. Chairman and members of the Committee. My name is Michael Staten. I am a Professor in the Norton School of Family and Consumer Sciences at the University of Arizona, and the Director of the Take Charge America Institute for Consumer Financial Education and Research. I've had the privilege of testifying before this committee previously when I was at Georgetown University, and am pleased to be able to join you again this afternoon.

I appreciate the Committee's wish to explore consumer education issues related to the development and use of credit scores and credit scoring models. From the consumer's standpoint, maintaining a good credit score is more important now than it has ever been. The rapid escalation in loan delinquencies and mortgage foreclosures over the past 18 months has caused many lenders to back away from higher risk applicants. A low credit score today can sharply limit credit availability, relative to the borrowing opportunities available as recently as two years ago. The widespread adoption of risk-based pricing in consumer lending means that a low credit score will also cost you money, possibly big money in the case of mortgage and auto loans. In addition, the bar has been raised for qualifying for the best interest rates. Two years ago you might qualify for the best mortgage rates with a FICO score of 720 – 750. Today, you will likely need a score well above 750 to get the best rates. The same is true for auto loans, especially on the subsidized dealer or manufacturer financing deals (heard in radio ads, etc).

Credit scoring impacts consumers outside of loan markets as well. Landlords routinely pull credit reports and may reject apartment rental applications or require a higher deposit or cosigner to compensate for a lower credit score. Cell phone service providers routinely pull credit reports, as do many utility companies. Many insurance companies use credit reports and scores in the decision to approve and price property and casualty insurance policies. Some employers also obtain credit bureau information, including credit scores, in evaluating applicants. In short, a consumer's credit report and the resulting credit scores have become an important dimension of personal financial management.

Consumer awareness of credit reports and the importance of credit scores has improved in recent years, but much education remains to be done. The Consumer Federation of America has partnered with Providian and Washington Mutual Bank to sponsor a series of consumer surveys since 2005 that track consumer knowledge of credit scores. The latest edition of the survey released earlier this month (Consumer Federation of America, 2008) found that only half of U.S. adults had obtained their credit score within the past two years. While this was a distinct improvement from the 42% who answered similarly in the prior year's survey, answers to other questions in the survey indicate a significant gap in knowledge of how scores are used between those who have viewed their scores and those who have not. Overall, the survey indicates that a large portion of the population has yet to focus on management of their credit history and credit score as part of their personal financial affairs.

In my testimony today I'd like to make two main points. First, business reliance on credit reports and credit scoring to make decisions about financial transactions is here to stay. Credit scoring has proved overwhelmingly superior to the manual judgmental loan evaluation systems of a generation ago, for a variety of reasons. Widespread adoption of credit scoring as a decision tool has generated significant benefits for consumers and transformed the U.S. consumer financial markets into the most competitive in the world. Because they are so useful, scoring models have been constantly improving, and will continue to do so as long as financial institutions compete for customers. My second point springs from the first: because the use of scoring is so commonplace in financial transactions, consumers need to develop a better understanding of the importance of their credit histories and credit scores, and better awareness of their power to manage the components to obtain more favorable offers in the financial marketplace.

In the following sections I respond to the committee's request for information about the development of credit scoring models and the use of credit scores in underwriting. Based on this information, I also offer some suggestions regarding the most important things that consumers should know about their credit scores.

**The Evolution of Credit Scoring as a Key Decision Tool for Lenders**

Possibly the most significant development in consumer lending in the past 25 years has been the widespread adoption of credit scoring as a standard tool for evaluating applicant and account risk. During this period, lenders shifted from manual and judgmental systems for evaluating credit decisions to automated underwriting using statistical scoring, dramatically impacting the supply of consumer and mortgage credit in the U.S. The quantity of available credit has greatly expanded as scoring facilitated better sorting of the pool of potential borrowers according to likelihood of default. Credit decisions are made much faster and at far lower cost. Compared to the manual loan decisions of a generation ago, scoring brings consistency to credit decisions companywide, supports highly accurate estimates of portfolio losses, allows for rapid implementation of company-wide changes to lending policy, and provides greater

assurance that lending decisions will comply with regulatory rules regarding fair-lending practices. It is no wonder that lenders have embraced credit scoring across all dimensions of consumer lending, and in other credit-related businesses.

Credit scoring is not the lending decision: it is a tool to assist the lender in making a decision. Through most of the past century in American consumer finance, lenders trying to assess a borrower's creditworthiness have been guided by an industry maxim known as the five "C"s of lending: Character, Capacity, Capital, Collateral, and Conditions. An evaluation of "character" is really an assessment of the borrower's willingness to repay, typically gauged by the borrower's past payment behavior and current use of credit. Capacity refers to the size, source and stability of the borrower's income stream relative to existing (and proposed) debt obligations. Capital refers to the borrower's assets, liquid or otherwise, which could be tapped if income proved insufficient to meet the required payments. The value of Collateral, and the possibility that it might be repossessed by the lender, comes into play on secured loans such as automobile loans or home mortgages both as an incentive to the borrower to continue making payments and as an assurance to the lender that some portion of the loan principal could always be recovered through sale of the repossessed asset. Lastly, an assessment of economic Conditions is prudent because they are likely to affect the borrower's capacity to repay.

Until the late-1960s, consumer lending decisions in the United States were typically made by thousands of loan officers who each exercised their individual judgment with each new application. Loan officers gathered information from and about the applicant in each of the five critical areas and applied lessons from their personal lending experience to decide whether an application should be approved. However, a number of factors combined to push the consumer credit industry away from this "judgmental" model of underwriting. The judgmental approach was too slow and labor intensive in the face of the enormous post-World War II boom in consumer loan applications. More importantly, the inconsistency inherent in a fragmented, judgmental approach rendered a company-wide underwriting policy nearly impossible. Management had no way of expressing a corporate policy of accepting only applicants with a probability of default of, say, 5% or less. Loan officers were left to figure out for themselves the level of risk an applicant represented and whether that risk was acceptable to the company. As Lewis (1992) notes, "In a nationwide loan company with, perhaps, one thousand offices, there might be as many as two to three thousand people defining overall corporate policy."[1]

The advent of statistical credit scoring dramatically changed consumer loan underwriting. The "5 Cs" of lending were no less important for conceptualizing the factors that determined loan risk, but credit scoring gave lenders a powerful tool for rapidly and consistently evaluating a key component of risk (past payment behavior and current credit usage) as well as summarizing it via a numerical score that translated into probability of default. Between 1970 and 2000, judgmental credit decision systems in

[1] Lewis, 1992, p2-3.

consumer and mortgage lending were gradually supplemented or replaced with empirically derived, statistically sound scoring systems. This dramatic change in risk evaluation technology greatly reduced the subjective nature of the lending decision.

The conceptual rationale for statistical credit scoring is essentially the same as for judgmental lending: patterns observed in the past are expected to recur in the future. Borrower and loan attributes that have been observed to be associated with loan defaults in the past become the basis for expecting default on similar loans in the future. Using multivariate statistical methods and data on millions of loans made in the past, credit scoring models today are built to identify predictive relationships between a wide variety of variables and loan performance.

The first credit scoring models were built to guide the loan application process, and application scoring remains an important use of scoring technology. The primary concern in granting a new loan (although not the only concern) is whether the borrower will repay the loan as agreed. Consequently, most new-account application models have been built to predict the likelihood that a loan will default within a given time period, usually 12 – 24 months. Default has been defined in a variety of ways, but often refers to a loan that achieves a level of serious delinquency, e.g., 90 days or more, or generates a repossession or chargeoff loss for the lender. From the outset of scoring and through decades of evolution in commercially available models, discriminant analysis and multivariate regression techniques have been the most common statistical tools used to model loan defaults. These models calculate credit scores for each application in such a way as to rank applications according to their relative risk of a loan default. Typically, scoring systems are scaled so that a lower score signals higher risk. That is, applications that receive lower scores are more likely to default within a specified time period than are applications with higher scores.[2]

During the 1970s and 1980s, many lenders (and most of the large national lenders) invested in the development of proprietary custom application scoring models (Mays, 2004). A custom application scoring model is built for a specific loan product (e.g., general purpose credit card) using a single lender's account data and experience. Custom models typically incorporate both credit bureau data and application data. There are very few published studies of these models, perhaps not surprisingly since an accurate scoring model can confer a distinct competitive advantage on a lender. As scoring developed through this period, new ideas were plentiful, lots of variables were explored, and public discussion of successful model components could quickly dissipate the value of the intellectual capital acquired through scorecard development.

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[2] Some applicants with low credit scores will actually pay as agreed and some applicants with high credit scores will default. This fact underscores the probabilistic nature of risk assessment: at the time of the loan application the lender never knows with certainty who will repay and who will not. What the lender wants is a scoring system that will achieve significant separation in the score distributions of good accounts and bad (defaulted) accounts. More separation is better. This gives the lender more confidence that the event of a high-scoring applicant defaulting on a loan will be an anomaly. So, the key to building a good (predictive) application scoring model is to find readily observable borrower and loan characteristics that consistently distinguish consumers who will pay as agreed from those who will not. For an overview of how the typical scoring model is developed see Mays, 2004, pp 63-130.

The Federal Reserve Board recognized the increasing use of application scoring systems when it developed its Regulation B that implemented the Equal Credit Opportunity Act of 1974, and the ECOA amendments of 1976. Both pieces of legislation were intended to prohibit discrimination in lending by prohibiting the use of information on the borrower's gender, marital status, race, nationality, age and certain other attributes from consideration in the underwriting process. Regulation B established criteria that scoring systems must satisfy to be considered methodologically and statistically sound.[3]

By the mid-1980s a clear divergence in processing procedures had emerged across loan products. Larger loan transactions (mortgage and automobile loans) still warranted loan officer scrutiny of paper application forms, credit reports and supporting documents. However, credit card account application processing had become increasingly automated. In large part this was due to improved quality of credit report data and the demonstrated success of statistical scoring models in rapidly and accurately determining applicant risk. The drive to lower processing costs also favored automation, and further pushed the credit card industry toward risk assessment based mostly on credit bureau data. Information from a loan application was time-consuming to code into machine-readable form that could be used by the scoring models. Moreover, application data was costly to verify, which meant that it was subject to exaggeration and outright fraud. Verification would delay an approval decision, a clear negative for a retailer considering a new account application at the point of sale.

For all these reasons the consumer credit industry migrated to the use of statistical scoring of credit applications first for credit cards and only later for automobile loans and virtually every other type of consumer loan by the early 1990s. Last to accept scoring was the mortgage industry, but by mid-1996, credit scoring was endorsed as a valid tool for evaluating mortgage applications by the Federal Reserve (Avery, et al 1996) and by the government-sponsored-enterprises Freddie Mac and Fannie Mae. By the end of the decade automated underwriting of mortgages using credit scoring had become the industry standard (Stracka, 2000).

*Components of Scoring Models*

What types of information are scored? This, of course, depends on the outcome to be predicted. Credit scoring began as a tool for evaluating new loan applications. In the early days of credit scoring, model builders sought data that would approximate the various factors represented in the "5 Cs" of lending. Models were initially designed to incorporate information that was commonly collected on loan application forms as well as information from credit reports.[4] Credit card application data in the 1980s included attributes such as the applicant's age, time at current/previous residence, time at

[3] Interestingly, Regulation B made the case for using credit scoring to standardize risk evaluation even more compelling than did the economic efficiencies alone. The ECOA created liability for a lender if it could be shown that loan acceptance policies were based on prohibited attributes. Credit scoring gave lenders an easily monitored tool for demonstrating that their loan acceptance decisions were consistently based on ***economic*** factors associated with the borrower and loan that could be shown to impact loan risk.
[4] Eventually, loan application forms were redesigned to reflect the information found to be most useful to scoring models.

current/previous job, housing status, occupation group, income, number of dependents, presence of telephone at residence, banking relationships, outstanding debts and open credit accounts. In addition, the models would also utilize credit bureau variables including the number, type and recency of any delinquencies, balances on open accounts and lines of credit, and the number and type of creditor inquiries (an indicator of credit shopping and new account activity).[5]

Chandler and Parker (1989) demonstrated that U.S. credit bureau data outperformed application data in predicting risk on bank and retail credit card applications. Using models built to score bank card applicants, and data from a period during which credit card issuers still collected detailed application information, the authors found that application data without the credit bureau data yielded the lowest predictive power and fared poorly when compared with predictions based on any level of credit bureau data. The predictive power increased substantially when the models incorporated higher levels of credit bureau detail, with the most detailed model exhibiting predictive power 52% greater than the simplest credit bureau treatment. In fact, a model incorporating the detailed credit bureau data plus application data actually performed worse than a model based on the detailed credit bureau data alone. Perhaps this is not surprising given that most application data on bank card products is not verified because of the cost and consequent delay in the accept/reject decision. The authors noted that for most applicants (those with an established credit history) a detailed examination of credit bureau data alone provided the most accurate assessment of new account risk.[6]

*Generic Scoring Models and the FICO Score*

By the mid-1980s the predictive power of credit bureau information convinced credit score model developers that effective models could be developed with credit bureau information alone. Fair, Isaac Corp. and other scoring system developers (including the major consumer reporting agencies) created and introduced "generic" credit bureau scoring models that incorporated only information from credit reports. Generic scoring models marked a sharp departure from the custom application models based on data that was unique to a specific creditor's loan product and customer base. In short, generic scoring models opened up credit scoring to the entire credit industry.

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[5] Chandler and Parker (1989), pp 47-48.

[6] Lay observers of the consumer credit industry, including members of Congress, often misinterpret the credit card industry's lack of explicit consideration of income in the application process. Income has much intuitive appeal as an important predictor of repayment risk. But, credit bureau data allow a creditor to infer repayment capacity from the degree to which past and existing lines of credit have been utilized and whether payments were made on time or late. In short, risk assessment based on credit bureau data rewards those consumers who find a way to make their payments. This is why credit bureau data can be more predictive than credit card application data that is unverified. The empirical evidence of the predictive superiority of credit bureau data over application data might change if application data were verified. But, verification is costly. In the mortgage arena, where the stakes are larger (loan size, potential interest income and loss in the event of foreclosure), it pays to measure risk attributes more precisely. But for smaller loans like credit card loans, the number of accounts is much larger (driving up total risk evaluation costs), and the size of the loan is typically much smaller (reducing the potential loss). And, objective credit bureau data is readily available.

The first generic scoring model was brought to market by Fair Isaac Corp. in 1986 to evaluate new applicant risk on credit card solicitations mailed to consumers. In 1987, Management Decision Systems, Inc. (MDS) rolled out the first generic scoring models that used credit bureau data to predict bankruptcy. In 1989, in partnership with Equifax, Fair Isaac introduced the first general purpose credit scoring model that utilized its FICO score, a product that 15 years later would become so ubiquitous as to become nearly a household term. The first model was built using Equifax credit report data. By 1991, Fair Isaac had developed similar models for the other two major U.S. consumer reporting agencies (Experian and Trans Union) using their respective credit report databases so that all three major consumer reporting agencies were selling their equivalent of the FICO score product under each bureau's marketing brand.[7]

The precise composition of commercially available generic scoring models is proprietary.[8] According to the Fair, Isaac website (www.myfico.com) the key determinants of a consumer's FICO score can be divided into the five general categories described below. A consumer's FICO score may vary across the three credit bureaus because the FICO score obtained from each bureau is built on the information in that bureau's database. The content of consumer credit reports varies across the three bureaus. The website hints at the direction of influence of specific attributes and provides, in percentage terms, the approximate influence on the overall FICO score.

1. ***Payment history: Accounts paid as agreed, Late Payments, Delinquencies, Bankruptcies (35%):*** Fair, Isaac advises individuals who seek to improve their FICO score to always pay their accounts before the due date. Simply put, the fewer late payments, the better the score. In the event of a late payment, the more serious is the degree of delinquency, the greater the negative impact on the score. In addition, more recent late payments tend to be more indicative of future default than those that occurred in the past. And, a late payment in a consumer credit report that has relatively few accounts, or accounts that are only recently opened will have a greater negative impact than the same late payment in a credit report with more accounts that have been long established.
2. ***Outstanding Debt (30%):*** Fair, Isaac advises consumers who seek to improve their credit score to keep balances low, especially credit card balances. People who have used a large portion of the credit available to them tend to be higher risks than those who use credit conservatively.

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[7] Over the years Fair Isaac has developed several versions of its FICO score products tailored for different market segments (e.g., FICO Classic, NextGen, and Expansion score products). The FICO Classic model is the one most commonly referenced and the one dissected on the firm's website with advice for consumers. The three major consumer reporting agencies collaborated to develop their own generic scoring model which hit the market in 2006 as VantageScore.

[8] For a variety of reasons, commercial generic scoring models such as the FICO score are typically constrained to the 10-20 most predictive variables from the credit report. Also, generic bureau scorecards marketed to date have generally been customer-based rather than loan-based models. That is, the observation unit for the generic bureau scorecard is a consumer, not a loan, and the dependent variable describes whether a consumer with a given credit profile at the start of the observation period becomes seriously delinquent (90+ days) by the end of the period (18-24 months) on at least one account.

3. ***Length Of Credit History (15%):*** Importantly, for a consumer to have a credit score, they must have some history of using credit. In addition, Fair Isaac advises that the longer someone has had credit established, the better is his or her credit score.

4. ***New Applications For Credit, or Inquiries (10%):*** Fair, Isaac advises individuals to apply for new credit sparingly if they seek a better credit score. In particular, they suggest that borrowers should not open lots of new accounts in a short period of time, as multiple new account acquisition can be a sign of financial distress and higher risk.

5. ***Types of Credit in Use (10%):*** The model considers how many types of credit accounts (credit cards, mortgage, auto loans, other installment loans) a consumer has, and how much credit usage falls into one category vs. others. The website notes that a good score doesn't require accounts in all categories, and that opening accounts just to broaden the mix probably won't boost the score.

Generic credit bureau scores (e.g., FICO scores) are now used to evaluate individual credit risk in virtually every sector of the consumer and mortgage credit industry in the United States.[9] The nearly instantaneous availability of rich and comprehensive credit bureau information on a borrower, coupled with the proven predictive power of scoring models has made instant credit at the point of sale commonplace. The industry-wide shift from manual to automated underwriting transformed the competitive landscape in the U.S. by encouraging new entry into the consumer lending business (at much lower cost than would be the case for a new lender in nearly every other country) and bringing a broader range of product offerings, wider credit availability and lower prices to consumers.

In addition, generic credit bureau scores are frequently combined with additional data from existing account activity to give a lender a powerful "behavioral score" decision tool for existing accounts. Behavioral credit scoring is now used to determine when and how much to increase the limit on credit card accounts; approve authorizations of new credit card purchases at the point of sale; monitor credit card account transactions for possible fraudulent activity (including identity theft); predict account attrition so that lenders can take steps to recruit and keep loyal customers; initiate collection strategies on delinquent accounts, set their tone and predict dollar recoveries; select potential new customers for receipt of pre-approved invitations to apply for credit; and identify existing customers who may respond favorably to the cross-selling of other products.

*Three Criticisms of Scoring*

Debate over the pros and cons of reliance on credit scoring often incorporates one or more of the following criticisms: 1) generic credit scoring models are biased against consumers in certain minority groups because the models include credit-history items that

[9] Chandler (2004) catalogued 70 different generic credit scoring systems containing over 100 different scoring models or scorecards that were available in the market as of 2004 to assist in a wide range of credit decisions.

may have a differential (and negative) impact on certain minority groups; 2) lender decisions based on credit-history scoring models (i.e., generic models) are flawed because of errors in credit reports, and 3) generic scoring models rely on credit report data that is an incomplete picture of a consumer's ability to handle recurring monthly obligations such as rent and utility payments. A thorough discussion of each criticism is well beyond the scope of this testimony, but below I offer some short observations about each.

Regarding the fairness of scoring models toward minority groups, the Federal Reserve Board in 2007 released a major study of the issue as required by the Fair and Accurate Credit Transactions Act of 2003 (FACT Act). In the report, the Fed researchers concluded that generic, credit-history-based scoring models do not have a differential and negative impact on certain racial minority groups. None of the credit characteristics in standard models were found to serve as proxies for race or ethnicity. However, the researchers also noted that recent immigrants have somewhat lower credit scores than would be implied by their actual performance on loans. This is because their credit histories resemble those of young consumers (e.g., fewer accounts and shorter history, relative to general borrower population) who generally perform somewhat worse on credit repayment. The researchers suggested that expanding the information supplied to credit reporting agencies to include rent payments and other recurring bill payments would possibly enhance the credit profile of these consumers.

Credit reporting agencies and scoring model vendors have recognized that conventional credit reports are missing information that could be useful for predicting loan performance. In fact, the industry is breaking new ground in the collection and use of alternative payment history data for consumers with little or no past credit history captured in traditional credit reports. As of 2006, an estimated 35 – 54 million American adults had limited or nonexistent credit files (Turner, et al, 2006). Most of these consumers in what the industry calls the "thin file/unscoreable population" are new to or completely outside of the credit-granting system, either because they are young, or are recent immigrants or have simply operated on a cash basis or through non-traditional sources of credit. Their lack of traditional credit history makes them appear to lenders as high risk when, in fact, they are often not. Data on payments for rent, utilities, insurance premiums, pay day advances, and rental furniture could enhance scoring models. Utility and telecommunications sources of data show the most promise, as studies estimate that 90% or more of the thin file/unscoreable population has one or more such accounts. The major consumer reporting agencies, established scoring vendors (e.g., Fair Isaac) and new entrants to the credit reporting industry are exploring how to collect, store, and score monthly bill payment data that has traditionally not been reported to the major consumer reporting agencies. Success on this front will undoubtedly expand credit availability and open up a large consumer market to competition from major national lenders.

As for the accuracy of information that is utilized by credit-history-based scoring models, this is a decades-old issue that has yet to be definitively resolved through empirical evidence. I only point out here that this is more of a "reporting" problem than a "scoring" problem. The effectiveness of scoring will always depend on the quality of the

underlying information being scored. In the absence of credit scoring, lenders would still be basing their decision on the content of credit reports, flawed or otherwise. Erroneous information can lead to bad decisions in both judgmental and automated scoring systems. Recognizing this, Congress included one requirement in the 2003 FACT Act (Section 319) that directs the Federal Trade Commission to study the accuracy and completeness of information in consumers' credit reports and make a series of biennial reports to Congress over a period of 11 years beginning in December 2004. The FTC is currently undertaking a series of pilot studies to determine the feasibility of engaging a nationally representative sample of consumers in a review of their credit reports from the three major consumer reporting agencies. Should the large national study take place, it could provide the first reliable evidence regarding incidence of such "errors of commission" and their impact on consumer credit scores.

In this area, the consumer plays an important but underutilized role. Although participation is improving, too few consumers understand the importance of credit scores, and too few check their credit reports. Under the Fair Credit Reporting Act (FCRA), Congress gave the consumer the role of "quality inspector" with the power to dispute and initiate re-investigation of any piece of information in the credit report. For consumers to find errors, they have to look. Much of the FCRA's effectiveness in promoting accurate credit reporting hinges on consumer willingness to exercise the power to monitor their reports. Given the heightened consumer awareness of credit scoring (especially for mortgages), concerns over identity theft, and the right to one free annual credit report (per bureau) under the FACT Act, it seems likely that consumers will inspect their reports more often than was the case a decade ago, and the problem of "errors of commission" in credit reports will gradually diminish.

**What Should Consumers Know About Credit Scores?**

Credit scoring is no longer the impenetrable "black box" that it may have appeared to consumers are recently as 2001. Even prior to the FACT Act in 2003, the major consumer reporting agencies and scoring model vendors recognized a marketing opportunity and began to view consumers as customers of scoring information products, including a host of credit score monitoring and ID theft alert services. Today, numerous websites, originating in both the public and private sectors, provide consumers advice on how to understand their credit reports and what goes into determining their credit scores. Managing a FICO score into the "700 club" has gained a bit of a cult following (WSJ, 2008), with advice flying around the internet regarding how to manipulate account balances and manage existing accounts to tweak a score to a higher level.

Yet, according to the Consumer Federation of America surveys, a large proportion of U.S. borrowers still don't understand what a credit score represents or the factors that determine a score. Far more important than coaching to tweak their scores, American borrowers should be aware of the following points:

- Your credit score reflects your decisions. Consumers have the ability to raise and lower their scores. Because credit scores reflect a consumer's own past payment history and current use of credit, consumers can control their own score to a large degree, especially over time. This makes a credit score an important but underappreciated personal financial management tool.

- Failing to properly manage your credit score costs you money: sometimes big money. Fair Isaac's myfico.com website provides ready examples of loan rates that correspond to various score ranges. The cost differential between low scores and higher scores can easily translate into hundreds of dollars per month in additional finance charges for larger loans such as home mortgages

- Knowing your score – and knowing what lenders consider to be a good score and a poor score - helps you shop and recognize a good offer from a bad one

- Your FICO and VantageScore credit scores are based solely on information in your credit report, so check your credit report periodically to see what is there and be sure that what is there is correct.

Thank you for the opportunity to contribute to your discussions.

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# PERC Testimony
# Before the Oversight and Investigations Subcommittee of the Financial Services Committee

**By Dr. Michael A. Turner, President and Senior Scholar**
**Political & Economic Research Council (PERC)**

**Tuesday, July 29, 2008**

**On the Topic:**

## "What Borrowers Need to Know about Credit Scoring Models and Credit Scores"

Good afternoon Chairman Watt and Ranking Member Miller. Thank you both for your invitation to testify before this subcommittee on issue of great social and economic importance. My name is Michael Turner, and I am President and Senior Scholar at the Political & Economic Research Council in Chapel Hill, North Carolina. PERC is a non-profit, non-partisan policy research organization focusing upon market-based economic development in the US and globally.

Today, at your invitation and based upon guidance from your staff, I will address automated underwriting and the extensive role it has played in improving access to credit for all Americans, but particularly minorities and the poor. Then I will address how the data collected and used for credit risk assessment is evolving, and how a growing number of non-financial firms that traditionally have not provided payment information to credit bureaus have started doing so, and the extraordinarily positive effect that these developments have had to further enhance credit availability, again particularly among minorities and the poor. I will

then examine whether alternative data is accurate, and whether there are incentives of furnishers to accurately report Finally, I will conclude with a brief discussion of the adequacy of disclosures to consumers who are purchasing their credit scores.

**Co-Evolution of National Credit and Credit Reporting Markets**

The growth, development, and performance of the national consumer credit marketplace is integrally linked to the national credit reporting system. Since the enactment of the Fair Credit Reporting Act in 1970, as highlighted in an earlier PERC study that was presented to Congress in 2003, the evolution of regional and national consumer credit markets in the United States have been enabled by the increased use of sophisticated credit decisioning tools that rely upon credit file data.[1] In fact, the pervasive use of automated underwriting solutions by mainstream lenders has yielded considerable social and economic benefits, including:

- Between 1970 and 2001, the overall share of families with general-purpose credit cards increased from 16 to 73 percent (Federal Reserve);
- The percentage of households in the lowest income quintile with a credit card has increased from 2 percent in 1970 to 28 percent in 2001 (Federal Reserve);

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[1] Turner, Michael A. *The Fair Credit Reporting Act: Access, Efficiency & Opportunity—The Economic Importance of Fair Credit Reauthorization.* Washington, DC: The National Chamber Foundation of the U.S. Chamber of Commerce, 2003. Publication #0320.

- During the same period, the percentage of African American households with credit cards has more than doubled, from 23.6 percent to 55.8 percent (Federal Reserve); and,
- Competition, credit scoring, and technology have reduced the consumer's price for credit card credit. Assuming constant prices for credit card credit since 1997, PERC estimated the consumer savings from increased competition in the credit card industry to be about $30 billion per year from 1998 to 2002.[2]

However, the system is not perfect. Specifically, as we all know, it is often difficult for consumers to enter the credit market. To start down that path - you can't get credit because you don't already have credit, and you don't have credit because you don't have any credit history. This is the "credit catch-22" confronting many potential first time borrowers.

However, several developments over the last 10 years, pioneered by cutting edge research by PERC, the Brookings Institution's Urban Markets Initiative and others, has started to ease that transition for millions of Americans. Specifically, because of the increasing availability and acceptance of so-called "alternative data," millions of Americans are now facing a shortened path to entering the credit "mainstream."

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[2] Ibid. Pg. 98. Calculated from figures in Revenue figure derived from *Credit Card Management*. "A Little Help from UNCLE SAM." Published by Thomson Financial. Article shows 2001 revenues of $92.47 billion and charge-offs of $29.87 billion. Thus, revenues net of charge-offs are $62.6 billion.

**What is alternative data?**

Traditional consumer credit files most commonly include, among other information, records of credit and payment obligations between individuals and creditors, typically financial organizations or retailers. Mortgage loans, student loans, auto loans, and credit cards are the most common examples of traditional credit data contained in a personal credit report. "Alternative" or "non-traditional" data are other payment obligations from non-financial institutions that are generally either not reported at all to credit bureaus, or are under-reported. While there are many potential data sets contained in the universe of "alternative" data, some of the more prominent ones include energy utility, telecoms, rental, remittance, and insurance payment data.[3]

In the Federal Trade Commission's Report to Congress as per Section 319 of the 2003 Fair and Accurate Credit Transactions Act (FACT Act), the FTC noted a variety of different alternative data sets being tested in the market.[4] In a follow on study to the FTC's report, PERC's Information Policy Institute released a report that identified energy utility and telecoms payment data as the most promising alternative data sets given the objective of increasing financial

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[3] Afshar, Anna. "Use of Alternative Credit Data Offers Promise, Raises Questions," *New England Community Developments: Emerging Issues in Community Development and Consumer Affairs*. Federal Reserve Bank of Boston: Issue 1, Third Quarter 2005.

[4] *Report to Congress Under Sections 318 and 319 of the Fair and Accurate Credit Transactions Act of 2003.* Washington, DC: Federal Trade Commission.

inclusion in America.[5] Energy utility and telecoms payment data are the most promising data sets, given the objective of increased financial inclusions, as they:

(1) have broad coverage among the thin-file and no-file population so that if the data is predictive then the greatest number of thin-file and no-file persons will benefit;
(2) they are derived from relatively concentrated industries so collection will be less of a challenge; and,
(3) they reflect credit-like transactions in that a good or service is provided before payment is required.[6]

The report also examined technological, economic, and regulatory barriers to having these two alternative data sets reported to credit bureaus and consumer reporting agencies. While there were few technological or economic barriers of note, there were varying prohibitions in four states—CA, NJ, OH, and TX—that preclude the onward transfer of customer payment data to third parties. In addition, there exists considerable "regulatory uncertainty" in the states. Many state regulatory commissions are unwilling to grant permission to regulated utilities and telephone companies to report without direction from the statehouse—despite the absence of any statutory prohibition.[7]

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[5] Turner, Michael A. *Giving Underserved Consumers Better Access to the Credit System: The Promise of Non-traditional Data.* New York: The Information Policy Institute at PERC. 2005. Downloaded from www.infopolicy.org/pdf/nontrad.pdf
[6] Ibid. Pg. 14.
[7] Ibid. Pg. 21.

Based upon its initial research, PERC hypothesized that the most effective means to help the greatest number of thin-file and no-file persons develop a credit history in order to access affordable sources of mainstream credit was to have energy utility and telecoms customer payment data fully reported to traditional credit reports, and to promote scoring models that are better able to incorporate alternative data into a credit score. Currently, 91 percent of energy utility and telecoms firms surveyed by PERC report only negative data to credit bureaus, either directly or indirectly through collections agencies. By contrast, PERC advocates that energy utility and telecoms firms report both late and timely payment information. We want people to benefit from their good payment history, not just be penalized for late payments.

PERC then proceeded to empirically test this hypothesis. This is an important point—whether or not various sets of alternative data are predictive of credit risk, credit capacity, and credit worthiness are empirical and objectively measurable questions and not merely theoretical and speculative.

**The Social and Economic Value of Fully Reporting Alternative Data**

As discussed above, tremendous strides have been made in making credit access both fairer and more affordable, but there are still an estimated 35 to 54 million Americans who remain outside of the credit mainstream owing to

insufficient credit information about them.[8] Because of this information gap, millions of Americans still cannot be scored. In such cases, the default position of mainstream lenders that heavily rely on automated underwriting solutions is to reject an unscoreable credit applicant as being too high of a risk to provide credit

This rejection is consequential. The two primary means by which Americans build assets and create wealth are homeownership and small business ownership. And both of these typically require access to credit, and decisions about credit are based upon the borrower's risk profile (e.g. the business owner, and not the business). In this context, the lack of sufficient data in a credit file acts as a barrier to wealth creation, opportunity, and social and economic advancement.

The good news, however, is that that world is changing, and changing rapidly. The tens of millions who might otherwise have been left outside the mainstream credit fold, because there is insufficient or no information about them in their credit files, are finding that payment data reported by non-financial organizations is thickening their files and increasing their attractiveness to lenders.

We believe that the market has responded with an emerging solution. By fully reporting so-called "alternative data"—that is, reporting timely and positive payments on gas, electric, heating oil, water, wireline and wireless telecoms,

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[8] Burr, Sara and Virginia Carlson. "Utility Payments as Alternative Credit Data: A Reality Check." Milwaukee: Asset Builders of America, 2007. Downloaded from www.assetbuilders.org/pdf/PAID-casefor_final.pdf

cable TV, and rent—to credit bureaus and consumer reporting agencies, lenders are better able to see and understand this "thin file"" population, increasing their ability to obtain competitive loans and offers.

**Alternative data as a predictor of credit risk, credit capacity, and credit worthiness:**

For many alternative data sets, the jury is still out on this question. For energy utility and telecoms payment data, however, rigorous empirical testing by PERC and the Urban Markets Initiative at the Brookings Institution yielded irrefutable evidence that these "alternative data" data sets are predictive of an individual's credit risk and credit worthiness.[9]

As discussed above, much of this data is already finding its way into traditional credit reports, and it has tremendous potential. PERC and Brookings UMI examined a sample of over 8 million TransUnion credit files that contained one or more fully reported energy utility or telecoms (wireline and wireless) payment tradelines. A validation sample of a further 4 million randomly selected credit files was used for benchmarking.

The report had a strong focus on the impacts of fully reporting energy utility and telecoms payment data upon credit access for consumers outside of the credit

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[9] Turner, Michael A. Alyssa Lee, Ann Schnare, Robin Varghese, Patrick Walker. *Give Credit Where Credit Is Due: Increasing Access to Affordable Mainstream Credit Using Alternative Data.* Washington, DC: Brookings Institution Urban Markets Initiative and, Chapel Hill: Political and Economic Research Council, December 2006.

mainstream. In addition, the report examined impacts upon scoring model performance—10 commercial scoring models were used in the simulations, including four generic scoring models (VantageScore and TransRisk), three credit card models (thin-file, new account, bankruptcy), and three mortgage scoring models that rely on credit bureau data for internal routing decisions such as "needs more information." The key findings of the PERC/Brookings UMI report are compelling:

- ***Those with thin files have similar risk profiles as those in the mainstream when including alternative data in credit assessments.*** The evidence from the report suggests that most borrowers in the thin-file and no-file segments are not high risk in terms of lending. For example, by including fully reported utility payment data in credit files, 40% of African Americans who were previously unscoreable were found to have prime credit scores.
- ***Fully reporting alternative data dramatically increases credit access for thin-file borrowers: :*** Given that credit scoring models now exist that can generate a score based upon two and sometimes one credit tradeline, fully reporting alternative data such as energy utility and telecoms payment data virtually eliminates the phenomenon of unscoreability. Two-thirds of both the thin-file utility sample (60.3%) and the thin-file telecommunications sample (67.7%) become scoreable when alternative data are included in their credit files.

- ***Fully reporting alternative data broadens and deepens access to affordable mainstream sources of credit.*** Including energy utility data in all consumer credit files increases the acceptance rate by 10%, and including telecommunications data increases the acceptance rate by 9%, given a 3% target default rate using a VantageScore generic model.
- ***Minorities, the poor, the young, and the elderly are the greatest beneficiaries of fully reported alternative data:*** For instance, Hispanics saw a 22% increase in acceptance rates. The rate of increase was 21% for Blacks; 14% for Asians; 14% for those under 25 years of age or younger; 14% for those 66 years of age or older; 21% for those who earn $20,000 or less annually. In addition, renters saw a 13% increase in their acceptance rates, and those who prefer Spanish as their primary language (a proxy measure for recent immigrants) saw a 27% increase.
- ***Fully reporting energy utility and telecoms payment data can reduce bad loans.*** By integrating fully reported energy utility data, a lender's default rate (percentage of outstanding loans 90 days or more past due) declines 29%, given a 60% target acceptance rate. These reductions allow lenders to make more capital available and improves their margins, capital adequacy, and provisioning requirements. Such improvements have further positive economy-wide effects.
- ***More comprehensive data can improve scoring models.*** In the PERC/Brookings UMI report, we assume that creditors interpret little or no data as the highest credit risk. As a result, when fully reported utility or

> telecoms trade lines are added to credit files, we see a significant rise in the KS statistic—an industry gauge to measure model performance. Specifically, we see a 300% rise for a sample of thin-file consumers, and a nearly 10% rise for the general sample. In the most conservative case, in which the general sample is used but unscoreable credit files are excluded from the calculations, we still find a 2% improvement in model performance with the addition of alternative data.

There is further *prima facie* evidence from the market that suggests that other alternative data sets may also be predictive of credit risk, credit capacity, and credit worthiness. Rental payment information has been used by Freddie Mac's and Fannie Mae's models as deployed by Loan Prospector and Desktop Underwriter with success. Mortgage insurers including Genworth Financial have been using rental payment data, energy utility and telephone payment data, and other alternative data for underwriting purposes for affordable housing loan insurance for almost two decades. FirstAmerican Credco's Anthem score similarly uses rental payment data to successfully assess risk.

To be sure, a growing number of mainstream lenders are adopting scoring models to account for alternative data reported directly to credit bureaus or CRAs. But this data is not yet widely reported. As a result, innovative new firms like PRBC, Link2Credit, RentBureau and VantageScore are offering solutions. Larger and established players like Experian, Fair Isaac, Lexis-Nexis, SAS, and

TransUnion are also introducing new products that are predicated upon using alternative data in credit risk assessment. On a larger level, these data, like financial data, will prove to be more predictive in some models and less so in others. Ultimately, scoring is an empirical not explanatory enterprise.

**Why alternative data furnishers provide bureaus with accurate data.**

On the face of it, there appears to be good reasons to be skeptical that non-traditional data providers have less of an incentive to provide accurate data compared to traditional data providers. But our understanding that credit providers have an incentive to provide accurate data because they are also users of this data obscures the complexities of the structure of incentives in the traditional and non-traditional sectors, the history of reporting, and the institutions that promote accuracy in reporting.

Energy utility and telecoms firms have both direct and indirect incentives to report accurate data to credit bureaus and consumer reporting agencies. The first direct incentive pertains to operating costs. As the rate of inaccuracy rises, it is almost certainly the case that the customer service and administrative costs for the furnisher providing the inaccurate data will also rise. Given the data furnisher obligations under the Fair Credit Reporting Act, highly inaccurate data will result in a large number of disputes, the resolution of which requires resources. Firms have a compelling market incentive to control costs, making it unlikely that any

firm with a high error rate in the payment data reported to a credit bureau would continue to report without dramatically improving the accuracy of its data.

The second direct incentive concerns improved cash flow. According to PERC's recent survey, every firm energy utility and telecoms fully reporting to a credit bureau witnessed a decline in delinquencies and charge-offs. This reduction had a positive cash-flow impact. Respondents to the forthcoming PERC survey also indicated that the perceived benefits from reporting outweighed the perceived costs. Reporting inaccurate data would fundamentally alter this cost/benefit equation, and affect firm level decisionmaking about whether to report.

And the logic behind the provision of data by these utility and other non-traditional data providers for them rests in the promise and observed fact that they can reduce charge-offs and late payments by reporting because consumers would have stronger incentives to pay on time. Relatively high levels of inaccuracy would destroy the incentive on the part of the consumer to pay on time. That is, if what gets reported on a consumer may or may not be true, and if a consumer can be sanctioned when paying on time and rewarded when paying late in unpredictable ways, consumers will have no incentive to pay on time as a result of reporting. In short, as the rate of inaccuracy grows for data furnished by a utility or telecom firm, the lower the value of reporting becomes to the furnisher.

There are also powerful indirect incentives to ensure that data reported by energy utility and telecoms to credit bureaus is accurate. Both for non-traditional and traditional data, data repositories have an incentive to monitor and promote data accuracy. Inaccuracy hurts the consumer to be sure, but it also hurts the lender. Less accurate data is less predictive. Poor data can adversely affect the performance of models and thereby portfolios. For bureaus, providing poor information is to provide a substandard product to your consumer (here the bank), and is bad for business. The industry's investments in reporting and dispute verification systems were born out of this incentive structure. That is, the repositories have a strong incentive to not accept, and to subsequently reject, poor quality data.

**Alternative data: Current reporting practices and emerging trends**

It should be noted that the vast majority of utilities (at least as indicated by results from PERC's forthcoming national survey of utility companies) do already report negatives to bureaus directly or indirectly through collections. 90 days past due (and sometimes 60 days past dues) reach consumer files. (30 days past dues is treated as an indeterminate, neither a good nor a bad payment, by most.) Consumers are already punished for late utility payments. Unfortunately, they often just aren't generally rewarded for timely ones. PERC, and its applied study center MAIN—the Markets and Information Nexus—are committed to changing the status quo and exhorting energy utility and telecoms companies to fully report customer payment data to consumer reporting agencies.

**Concerns associated with fully reporting alternative data.**

In concept, alternative data can improve access to credit for individuals who pay their utility and telephone bills on time. It can generate systemic benefits by reducing errors due to omission, thereby decreasing the probability of default to lenders. And fully reporting alternative data provides increased protection for borrowers who are not well positioned to undertake debt. However, the use of alternative data in credit risk assessment and loan underwriting is in its infancy in some ways, though it should be noted that alternative data collected manually (e.g., rental histories) have been used for a long time by some lenders and mortgage companies, notably Fannie and Freddie.

Since the public release of the PERC/Brookings UMI study, PERC has given over 50 public presentations on the report's key findings to lawmakers, regulators, industry executives, and consumer advocates both domestically and internationally. During this time, PERC staff have heard expressed several concerns about potential harms from having energy utility and telecoms payment data fully reported to credit bureaus and consumer reporting agencies. The following three primary concerns were most frequently voiced:

- New borrowers who receive credit as a result of having alternative data reported will quickly find themselves over-extended;

- Reporting alternative data will result in lower credit scores for most; and,
- Chronic late payers will be harmed as a result of having a subprime score.

Just yesterday, PERC, in conjunction with its applied study center the Markets and Information Nexus (MAIN), released an empirical study titled "You Score, You Win" at the National Press Club that specifically addresses each of these questions.[10] The key findings from the report are:

- No evidence in our data that those who open new accounts after having only non-financial accounts become over-extended and witness declines in credit scores;
- No evidence in our data of deteriorations of credit score over time for those with non-financial payment data in the credit files and little or no traditional payment data;
- No empirical or theoretical evidence to support the notion that chronic late payers would be harmed by fully reporting energy utility and other payment data to credit bureaus; and,
- All evidence suggests that reporting payment data serves both as a consumer protection and as a system wide protection.

Another concern expressed is the tension that exists between an individual's desire to maintain their good credit, on the one hand, and a requirement that they provide a disconnection notice to be eligible for state assistance grants to pay

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[10] Lee, Alyssa, Michael Turner, Robin Varghese and Patrick Walker. *You Score, You Win: The Consequences of Giving Credit Where Credit is Due.* Chapel Hill: Markets and Information Nexus (MAIN) at the Political and Economic Council (PERC). July 2008.

their utility bills on the other.[11] No one should be forced to choose between protecting their credit score and keeping the heat on. We initially were concerned by this practice, but since we have had discussions with many utility providers in the course of conducting research for our forthcoming study of potential data furnishers, we've come to suspect that this problem is very rare as very few locales (none we could actually identify) require a turn-off notice.

To the extent that the problem does exist, states and municipalities must change the eligibility criteria. There are ample other criteria—for example, that an individual receives other forms of government assistance—that demonstrate financial need and that do not require someone to avoid paying their bills on time.

Here it should be noted that the practice of using energy utility, telecoms, and other non-financial payment data for credit risk assessment purposes is neither new, nor unique to the United States. This practice has been ongoing in several emerging markets characterized by large credit-underserved populations. PERC was able to conduct quantitative analysis using 5 million Colombian credit files containing alternative data to verify the predictive value of fully reported non-financial payment data in Colombia.[12]

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[11] Saunders, Margot. Testimony regarding "Helping Consumers Receive the Credit They Deserve," before the United States House Subcommittee on Financial Institutions and Consumer Credit. 12 May 2005.

[12] Turner, Michael A. and Robin Varghese. *Economic Impact of Payment Reporting Participation in Latin America.* Chapel Hill: Center for Competitive Credit (CCC) at the Political and Economic Research Council (PERC), May 2007.

This approach to extending credit access to the financial excluded in emerging markets has attracted considerable attention from the World Bank, the International Finance Corporation (IFC), the Consultative Group to Assist the Poor (CGAP), and the Inter-American Development Bank, all of which have requested consultations with PERC on this topic. In addition, a growing number of consumer advocacy groups, lawmakers, and regulators are endorsing PERC's Alternative Data Initiative to promote the full reporting of energy utility and telecoms payment data and to have all statutory and regulatory barriers to alternative data reporting removed.

**The adequacy of disclosures to consumers purchasing credit scores.**

There are literally thousands of different proprietary scoring models that perform dozens of different functions ranging from simple account maintenance to predicting the likelihood that someone will respond to a firm offer of credit. Scores can be developed in-house or by third party vendors. To suggest to consumers that there is a single score or scoring model with which they should be concerned is inaccurate and misleading because there is no way for a consumer to know what score a particular lender has chosen to use. For borrowers, far more important than a single score attached to a single model, is having a clear understanding of their broad risk tier or risk band—are they subprime, non-prime, near-prime, prime, or super-prime—and what measures they can take to either preserve their good credit or improve their credit standing

if it needs improving. Knowing their band will allow consumers to best negotiate the interest rate they deserve.

On this front, there is no great mystery to be solved. In so far as consumers pay their bills on time, and keep their debt levels manageable, they should always find themselves contained within a prime score band. Other factors such as inquiries don't affect one's overall credit profile except on the margins.

In the context of the adequacy of disclosures when an individual is purchasing a credit score, those sites may lead an individual to believe that there is only a single score of consequence, or that represent one score to be superior to another score, or that misrepresent the nature and use of scores are clearly inadequate and should be modified.

**Conclusion**

The research conducted by PERC, the Brookings Institution's Urban Markets Initiative, and now the Markets and Information Nexus at PERC has provided irrefutable evidence of the predictiveness of energy utility and telecoms payment data of credit risk and credit worthiness. Similarly, the research has shown the tremendous measurable social and economic benefits from fully reporting these alternative data sets, while demonstrating a lack of any apparent harm from their inclusion in credit files and use in credit scoring models. The same research also demonstrates that the method by which the greatest number of thin-file and no-

file persons can be brought into the credit mainstream in order to build assets and create wealth to improve their lives and life's chances is by promoting the pervasive full reporting of energy utility and telecoms payment data to credit bureaus and consumer reporting agencies.

Congress can play a role in helping achieve this socially and economically optimal outcome. They can work to help remove statutory barriers—including the perceived prohibition on sharing positive data contained in Section 222 of the Telecommunications Act of 1996 that some telecoms firms have unfortunately interpreted as permitting the reporting of only negative payment data but not positive payment data. Congress could also pass a law permitting energy utility and telecoms companies to choose to report their customer payment data to credit bureaus and consumer reporting agencies. This would remove the most significant barrier identified by NARUC in the states—that of regulatory uncertainty. Finally, Congress could act to exhort or incentivize energy utility and telecoms companies to fully report.

Thank you Chairman Watt and Ranking Member Miller for the opportunity to share PERC's perspective on fully reporting alternative data to credit bureaus and consumer reporting agencies.

TransUnion Testimony
Before the Oversight and Investigations Subcommittee of the
Financial Services Committee
United States House of Representatives

By Chet Wiermanski, Group Vice President
Global Analytic and Decision Systems, TransUnion LLC

Tuesday, July 29, 2008

On the Topic:

"What Borrowers Need to Know about Credit Scoring Models and Credit Scores"

Good afternoon Chairman Watt and Ranking Member Miller. Thank you for your invitation to testify before your subcommittee this afternoon. My name is Chet Wiermanski and I am Group Vice President in TransUnion's Global Analytic and Decision Systems business unit. It is my pleasure to appear before you today to discuss the important issue of credit scoring.

**The Evolution and Benefits of Credit Scores**

First and foremost, I think it is important to explain what a credit score is. A credit score is simply a numeric estimate of a consumer's predicted trait (*e.g.*, creditworthiness) based on an evaluation of several factors. Prior to credit scoring, lenders relied on individual loan officers to evaluate a credit application and determine whether the consumer was a good credit risk. Credit scoring standardizes that process within a lender's company and allows for a more objective and uniform review of applications. It is important to note that there is not "one" credit score for a consumer. The credit score is dependent on the model used to calculate it. Credit scoring models will vary among lenders, consumer reporting agencies, and credit score providers. Credit scoring models can vary within the same lender, such as if a lender uses one scoring model for a credit card, but a different model for a mortgage loan.

Lenders have used various types of scoring models to promote fair and uniform decision-making long before the arrival of generic credit risk scoring models developed using the databases of national credit bureaus such as TransUnion. These models were generally built based on the experiences of the individual lenders using them, and thus were based on a total population of a few thousand loans. Scoring algorithm development companies such as Fair Isaac were at the time, as they remain today, principal providers of these types of tailor-made scoring models, based on an individual lender's experiences and customer footprint.

By the late 1980s TransUnion was completing its journey toward becoming a nationwide consumer reporting agency. Among the many benefits for both lenders and consumers of the existence of nationwide consumer reporting agencies such as TransUnion are the facts that such a large, dynamically updated database, having thousands of active data furnishers, can be used as the basis to accurately and fairly assess credit risk and to develop scoring models which generally have far superior predictive performance than custom models, which were based on the experiences of a single lender. By harnessing the full and complete reporting of positive and negative data from thousands of lenders, generic credit scoring models have allowed lenders to more accurately predict their risk exposure at multiple levels. This allowed implementation of more granular, risk-based pricing strategies, which have in turn led to decreased cost, and increased availability of consumer credit. This phenomenon was described by the Information Policy Institute in their paper, "The Fair Credit Reporting Act—Access, Efficiency and Opportunity. The Economic Importance of Fair Credit Reporting Act Reauthorization." (June 2003)

TransUnion was the first of the nationwide consumer reporting agencies to bring these benefits to lenders and consumers when, in December 1987, we introduced the first generic model as an added dimension to the consumer credit report used to approve credit applicants. This first credit bureau-based scoring model, *Delphi*, which was developed to identify consumers likely to become bankrupt, was produced in conjunction with an Atlanta-based model developer named Management Decision Systems. Later, in conjunction with San Rafael-based Fair Isaac, another generic credit risk model was introduced, *Empirica*. In the ensuing years, *Delphi* and *Empirica* and their successors and competing products at the other nationwide consumer reporting agencies have grown to be more and more commonly used due to the benefits they provide to both lenders and consumers. For example:

1. A valid credit risk assessment tool for a variety of loan products and credit applications. Most models predict some dimension of creditworthiness, and are used throughout the account life cycle on a wide variety of credit-risk decisions. Other models predict account revenue, likely response rate, and collectability of past-due accounts, among many other outcomes.
2. Fair and objective. Credit bureau scoring models are based exclusively upon the account payment histories, public record information and credit inquiries generated by consumers when seeking credit. Demographic information that may be part of one's credit report, such as age, is not used to develop or calculate a credit score. As a result, the scores generated are fair and objective.
3. Surrogate for individual judgment. An alternative to, or supplement of, the use of automated decision systems using credit scores relies upon the judgment and local knowledge of individual credit or risk managers. If employment of individual decision-makers also results in a more human face being put on the process, this could translate to an advantage. However, this approach is also subject to being less objective, less consistently applied and less scalable from a cost perspective.
4. Uniform application. From the standpoint of risk management, uniform application of a decision criteria results in a loan portfolio (or group of insurance policies) which can be expected to perform uniformly over time. In contrast, the performance of loans or policies that were created using more subjective, individual criteria tends to fluctuate with less predictability. This is important to both risk managers and consumers, because the more predictable the risk, the less hedging must be built into the price of the financial instrument. For example, this is an important part of the reason that mortgage loans in the United States are roughly two hundred basis points less costly than in Europe. This is based on the existence of a reliable consumer credit reporting information infrastructure, which allowed the creation of highly predictable credit scoring algorithms. The GSEs endorsed and encouraged the use of these algorithms because they supported the securitization of mortgage loans.
5. Scalable. Credit decision making systems using credit scoring models can be scaled in two important ways: One, they are independent of volume, which means that they can be used to uniformly evaluate 10 or 1,000 or 1,000,000 decisions each day. Two, they can be calibrated to create precise risk tiers. A binary yes/no credit decision is no longer the

only option. Interest or premium rates or other levels of service can be offered to consumers based on the risk reflected in the score. Because they provide a very granular scale (*e.g.,* VantageScore™ ranges from 501 to 990), risk managers can adjust their decisions based upon the different points assigned by the scoring model.

6. Promote competition. As noted above, the use of risk scores allows financial institutions and property/casualty insurance providers to make decisions without reliance on local credit managers or agents. These systems offer important elements of scalability and objectivity that result in reduced customer acquisition costs and improved portfolio performance. This lowering of barriers to competition lowers costs and thus provides more choices for consumers in the marketplace. The increased competition among financial institutions and property and casualty insurance providers in the U.S. in the past 10 years is in part attributable to the deployment of decision systems that rely upon credit scores.

**The Underlying Processes of Credit Scores**

The components used to develop credit risk models and subsequently calculate a consumer's credit score are based on an objective approach whereby hundreds of candidate credit characteristics from the credit histories of millions of consumers are empirically evaluated and selected for their ability to distinguish future loan performance. The candidate characteristics evaluated originate from the collective experience of consumer credit risk experts who construct and apply different rules against the underlying contents of the credit reporting system from which the model is developed. The list of candidate characteristics, which grows with each generic model redevelopment effort, are analyzed and tested using advanced multi-variant statistical techniques which find the optimal combination of credit characteristics that are the most predictive of the credit risk for which the model is being constructed. Characteristics that are identified from this process are then evaluated by highly trained and experienced statisticians who review each characteristic identified in terms of their relative importance and relationship with other characteristics selected. Characteristics that cannot be rationalized from this process are then replaced with other characteristics and reevaluated until all characteristics selected for the final model can be logically understood and explained by the team of statisticians involved in the project.

**What Borrowers Need to Know about Credit Scoring Models and Credit Scores**

We believe that these four major points are important for consumers to understand about credit scoring models and credit scores:

a. First, consumers should be aware of the major building blocks of most credit scoring models:

i. History of prompt payments. An individual's history of prompt payments obviously contains several dimensions—first, what is the frequency and severity of any previous account delinquencies, or instances of non-payment or other default? How recent, or long ago, were these instances? How many years has the individual maintained prompt payments?

ii. Capacity to absorb additional debt. How fully has the individual maximized his or her available credit? What is the ratio of current outstanding debt to credit limits on open-ended accounts? How much debt has the consumer taken on?

iii. Recent credit-seeking behavior. What are the indications that the individual is actively seeking to obtain additional credit? The number of recent loans and the presence of recent consumer initiated inquiries are often an indicator of this. Many scoring models bundle similar multiple inquiries and count them as one inquiry as they are associated with a single effort such as shopping for home or auto financing.

iv. Balanced use of credit (credit cards, mortgages, installment loans). Does the consumer have a healthy mix of credit, such as unsecured credit cards, installment loans for autos or other major purchases, and home mortgages and is the consumer using them responsibly by not overextending their credit obligations?

b. Consumers should be aware that there are many different types of credit scoring models, and often many components—both generic and proprietary—to a lender's decision-making process. Creditors often apply additional, proprietary decision steps to supplement the credit scores received from their proprietary models and generic credit bureau models. It is often a combination of credit scores and the creditor's internal logic driven from credit applications completed by the borrower and information about the terms of the particular credit transaction, which together form the basis of the credit-granting decision. While a general awareness of credit scores and credit scoring is useful knowledge for individual consumers, we believe that it is a mistake to communicate to individual consumers that a specific score using a specific model will necessarily result in a particular outcome, irrespective of other circumstances.

c. In the long term, the most effective strategy for an individual is to focus on the accuracy and completeness of the underlying information in his credit report. It is the consumer's credit activity, as reflected on an accurate and complete credit report, rather than any particular credit score, that is key to producing the terms and conditions of offers which lenders and insurers are able to make to that particular consumer. (Credit reports can be checked annually at no cost through accessing www.annualcreditreport.com).

d. Credit history, and credit scores are essentially individual, although spousal and other authorized user behavior on shared accounts can impact the credit reports of both persons. At TransUnion, credit files are maintained and updated at the individual consumer level. Accounts jointly shared among two or more individuals will thus appear on the individual credit histories, and will impact the individual credit scores, of each. Therefore, the payment behavior of an individual who shares an account with others can impact the scores of each of those other individuals. The effect can endure after the account sharing has ended (*e.g.*, in the case of a divorce) since the liability for the debt incurred during the time in which the account was shared may continue to inure to each of those account participants.

**Common Misconceptions About Credit Scoring Models and Credit Scores**

Consumers should be aware of these misconceptions:

- Myth: My score will drop if I check my credit.
  Fact: Inquires associated with checking your own report and credit score are considered "soft inquiries" and have no negative impact on your credit score.
- Myth: There's only one score that all lenders use to determine my credit-worthiness.
  Fact: There are literally hundreds of different credit scoring models used by lenders in the marketplace today. To see where you stand from a lender's perspective, scores can be purchased online, but it's important to select a service that provides summaries that are easy to understand.
- Myth: Closing old credit card accounts will clean up your credit report and improve your credit score.
  Fact: Some people advocate closing old and inactive accounts as a way to manage their credit. In most cases, closing your older accounts will make your credit history appear shorter, which can negatively impact your overall credit score.

- Myth: Once you pay off a delinquent loan or credit card balance, the item is removed from your credit report.
  Fact: Negative information such as late payments, collection accounts and bankruptcies remain on your credit reports for up to seven years. Certain types of bankruptcies appear for up to 10 years. Paying off a delinquent account won't remove it from your credit report, but it will update the account to indicate it as "paid" and will over time improve your credit score
- Myth: If I don't pay a medical bill on time because I believe it is incorrect, I can't be held accountable.
  Fact: If you fail to pay a medical bill in a timely manner, the delinquent payment may be reported as late to a credit bureau. If you believe a medical bill you have received is wrong or was sent to you in error, it's best to contact the provider to resolve or discuss the matter prior to the bill becoming past due. (N.B.: The most recent versions of TransUnion's credit risk models (versions 3.0) do not consider medical collection accounts when calculating a consumer's credit score.)
- Myth: The credit bureaus report people as having either good or bad credit.
  Fact: Credit reporting companies compile information that is provided directly and voluntarily by lenders. If you have a credit card, home or auto loan, or make other monthly payments, details of your use and payment track record on these are likely being reported by those parties.

**The "Authorized User" Issue**

Some widely used scoring models have included authorized user accounts in their credit score calculations. This has produced an opportunity for score manipulation and fraud. Specifically, credit repair clinics and others have taken advantage of the fact that financial institutions generally have not scrutinized "authorized user" requests. Often for a substantial fee, the scam artist is therefore able to add his client as an authorized user to an otherwise creditworthy account (although the client is usually not provided use of the account in any real sense). Websites by persons seeking to cash in on this fraud by helping consumers exercise the scam sprang up and still exist today. As general awareness of this caper grew, some adjustments within the industry, among model developers, credit reporting agencies, and financial institutions have occurred.

At TransUnion, it has been our position that authorized user trades were not appropriate to include in credit scoring models and other risk evaluation products we developed. An authorized user has no contractual liability for the account—he or she has only been added to the account as an "authorized user", at the courtesy of the account holder. Some have argued that federal law (Regulation B, implementing the Equal Credit Opportunity Act) requires lenders in certain limited circumstances to consider spousal authorized user information when making a credit decision. This is a very nuanced issue, but existing available guidance does not appear to require the countenance of "authorized user" fraud. Furthermore, as noted above, consumer reports from consumer reporting agencies such as TransUnion do not contain information regarding marital status or spousal relationships. Therefore, TransUnion is not equipped to provide information regarding whether an authorized user is the spouse of the accountholder. However, we are committed to working with our customers to address any compliance issues that may arise in connection with the use of our scores.

**Score Disclosures to Consumers—Room for Improvement but still a Positive Trend Toward Financial Literacy**

TransUnion was the first nationwide consumer reporting agency to announce, in May, 2000, our plans to make scores available to consumers, upon request. In 2001, we implemented that plan, providing consumers with our proprietary *TransRisk*™ score—a scoring model used by hundreds of lenders in making millions of lending decisions. A growing marketplace soon evolved, to the point that today information on credit scores is widely available to consumers.[1] Our own affiliate, TrueCredit™, provides unrestricted daily access to an individual's TransUnion credit report information and his or her VantageScore™, in addition to file monitoring and other services, for a monthly fee of $11.95. (Access to credit reports and scores from all three of the major nationwide consumer reporting agencies [TransUnion, Equifax and Experian] is offered for $14.95 per month.) In addition, consumers exercising their rights to a free annual disclosure

[1] The disclosure of a consumer's credit score from a credit bureau is sometimes referred to as an "educational" credit score. We believe this term can cause misunderstanding. The term "educational score" suggests that the score in question is not used by actual lenders or insurers to make actual, real-world risk decisions. At TransUnion, the scores we provide to consumers are used by lenders and insurers. We believe that effective disclosure of many different scores, with the appropriate factors and the underlying credit report, can be educational for the consumer.

of their TransUnion credit report at the centralized site (www.annualcreditreport.com) maintained in conjunction with the other nationwide consumer reporting agencies, may also obtain their VantageScore™ for a fee of $7.95.

This balance between the right to obtain a free annual credit report and the right of the consumer reporting agencies to charge a reasonable fee for the sale of credit scores, subject to FTC oversight, was carefully crafted by the Congress in the 2003 amendments to the Fair Credit Reporting Act, in the FACT Act. Today, millions of consumers each year exercise their rights to obtain a free annual credit report, and many of these also opt for credit score disclosure. In addition, there are many other score disclosure services, such as those maintained by credit scoring providers, that also sell consumers credit scores based upon the underlying information contained in a credit report.

The Subcommittee has specifically asked whether a consumer can obtain a "stand-alone" credit score. TransUnion strongly feels that a credit score, derived from the contents of a particular credit report, must be understood in terms of that particular credit report. The score factors[2] which are normally provided to the consumer with the score are best viewed as pointers back into the detail of the credit report. If, for example, one of the factors indicated too much outstanding credit, or serious delinquency, the details essential to understanding those evaluations are contained in the credit report. We believe that, in terms of financial literacy and consumer education, a score alone, without the factors and the credit report upon which it is based, is inherently meaningless.

It is also worth noting that proposed regulations recently promulgated jointly by the Board of Governors of the Federal Reserve and the Federal Trade Commission under their rulemaking authority provided by the FACT Act's risk-based pricing notification provision may offer another opportunity to consumers applying for new credit to obtain a free credit score disclosure in certain circumstances.

We feel that access for consumers to information about their credit scores, and the factors that are used in calculating scores, is, manifestly, widely available. We believe that the challenge for all of us is to support efforts to increase the financial literacy of individuals about the operation of the credit reporting system in the United States which supports so much of our country's economic prosperity.

[2] The factors which most negatively impacted the score, as calculated by that particular scoring model.

To that end, TransUnion is proud to support several initiatives in the United States aimed at boosting Financial Literacy:

- Through our website, www.transunion.com and that of our affiliate, www.truecredit.com we provide educational information on credit reports and credit scores.
- As a proud national sponsor of the non-profit organization, Operation Hope.[3] Operation Hope is a leading global nonprofit social investment banking and financial literacy organization. Through various initiatives and programs, TransUnion is helping to educate inner-city families and youth on banking and credit financial principles.
- As a sponsor of the Jump$tart Coalition for Personal Financial Literacy.[4] The Jump$tart Coalition supports educational programs in personal finance. Jump$tart's website states that: "The Coalition's direct objective is to encourage curriculum enrichment to ensure that basic personal financial management skills are attained during the K-12 educational experience."

We believe that, by seeking to improve financial literacy, and by increasing the full-file reporting of "non-traditional" furnishers of credit/payment information from providers such as energy utilities, telecommunications companies, apartment rental management firms, among others, that more consumers can, at once, be brought into the mainstream credit economy and become more financially literate.

**The TransUnion Perspective on the Alternative Data Issue**

For more than 15 years, TransUnion has encouraged the full-file reporting of such "non-traditional" information furnishers as energy utilities and telecommunications providers. The positive benefits accruing to consumers, especially those with thin files, was examined and documented in the 2006 paper by the Political and Economic Research Council (PERC) and the Brookings Institute in their study, "Give Credit Where Credit is Due",[5] which TransUnion proudly supported. Just yesterday, on July 28th, PERC announced an update on this work with a new study entitled, "You Score You Win: The Consequences of Giving Credit Where Credit is Due." Also, earlier in 2008, TransUnion published our own white paper on the subject, zeroing

[3] http://operationhope.org.
[4] http://www.jumpstartcoalition.org.
[5] Turner, Michael A., Alyssa Stewart Lee, Ann Schnare, Robin Varghese and Patrick Walker. "Give Credit Where Credit is Due." Chapel Hill, NC and Washington, DC. The Political and Economic Research Council & The Brookings Institution Urban Markets Initiative. 2006.

in on the impact of full-file reporting by these industries on consumers with impaired credit, "Alternative Data: How the Use of Utility Data in Credit Reporting Impacts Both Lenders and Consumers with Blemished Credit."

In general, we believe the following points are worth emphasizing:

- There is a net benefit to consumers, particularly those with "thin files" to promoting more "full-file" reporting by new sectors of service providers, in particular energy utilities and telecommunications services providers.
- There is sufficient flexibility in the reporting framework to allow for exceptions created by special payment agreements to mitigate, or eliminate, adverse impacts on consumers in special, distressed, conditions.
- Best practices by service providers to notify their customers before inception of full-file reporting are critical—both to the provider and to consumers.
- The federal Fair Credit Reporting Act provides a robust, world-class, set of consumer rights covering access, rights to dispute, rights to correction, etc. to protect consumers.

We are presently engaged in a follow-up study with PERC to learn more about the impediments—whether systemic, political, legal or otherwise—which are faced by the utilities and telecommunications companies who might otherwise wish to begin full-file reporting. It may very well be that Congress may have a role to play in removing roadblocks and encouraging voluntary full-file reporting.

**Conclusion**

Chairman Watt and Ranking Member Miller, thank you again for the opportunity to present our views on this important matter this afternoon. We stand ready to work with you to provide additional information to support your efforts to explore the use of credit scoring models and credit scores.

BARNEY FRANK, MA, CHAIRMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

SPENCER BACHUS, AL, RANKING MEMBER

July 24, 2008

Honorable Ben S. Bernanke
Chairman
Federal Reserve Board
20th Street and Constitution Avenue
Washington, DC 20551

Dear Chairman Bernanke:

The Oversight and Investigations (O&I) Subcommittee of the House Financial Services Committee has scheduled a hearing entitled "What Borrowers Need to Know About Credit Scoring Models and Credit Scores" on Tuesday, July 29, 2008.

Section 701(b)(3) of the Equal Credit Opportunity Act (ECOA), provides that a creditor may consider age in a credit scoring model if the model is empirically derived and statistically sound in accordance with Federal Reserve Board ("Board") regulations.

In preparation for this hearing, I request that your agency provide a written statement explaining how the Board has implemented this requirement under the ECOA, particularly how the Board provides ongoing oversight that credit scoring models used by creditors are empirically derived and statistically sound. Please submit your response by July 28, 2008 in order that your response may be made a part of the hearing record.

Thank you in advance for your assistance in this matter.

Sincerely,

Melvin L. Watt, Chairman
Subcommittee on Oversight & Investigations
House Financial Services Committee

BARNEY FRANK, MA, CHAIRMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

SPENCER BACHUS, AL, RANKING MEMBER

July 24, 2008

Honorable William E. Kovacic
Chairman
Federal Trade Commission
600 Pennsylvania Avenue
Washington, DC 20580

Dear Chairman Kovacic:

The Oversight and Investigations (O&I) Subcommittee of the House Financial Services Committee has scheduled a hearing entitled "What Borrowers Need to Know About Credit Scoring Models and Credit Scores" on Tuesday, July 29, 2008.

Under Section 212(b) of Title II of the Fair and Accurate Credit Transactions Act (FACT Act), the Federal Trade Commission (FTC) is required to establish the definition of a fair and reasonable fee that consumer reporting agencies are allowed to charge for disclosure of a consumer's credit score.

In preparation for this hearing, I request that your agency provide a written statement explaining how the FTC has implemented this requirement under the FACT Act. Please submit your response by July 28, 2008 in order that your response may be made a part of the hearing record.

Thank you in advance for your assistance in this matter.

Sincerely,

Melvin L. Watt, Chairman
Subcommittee on Oversight & Investigations
House Financial Services Committee

BARNEY FRANK, MA, CHAIRMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

SPENCER BACHUS, AL, RANKING MEMBER

July 24, 2008

Mr. Jack Forestell
Senior Vice President, Business Analysis
Card Customer Management
15000 Capital One Drive
Richmond, VA 23238

Dear Mr. Forestell:

The Oversight and Investigations (O&I) Subcommittee of the House Financial Services Committee has scheduled a hearing entitled "What Borrowers Need to Know About Credit Scoring Models and Credit Scores" on Tuesday, July 29, 2008.

In preparation for this hearing, I request that your company provide written responses to the following questions by July 28, 2008 in order that your responses may be made a part of the hearing record:

(1) How does your company use both external and internally developed credit scores in assessing creditworthiness?

(2) How does the bank use credit scores to market your company's credit card accounts to potential customers and to determine the terms and conditions that are offered to new and existing credit card account customers?

(3) How does your company ensure that its use of external and internally developed credit scores is in compliance with the Equal Credit Opportunity Act and other laws?

(4) Does your company consider any sources of alternative data in assessing the creditworthiness of customers? If so, please explain.

(5) Does your company report full trade account information to each of the nationwide consumer reporting agencies for all of its credit card products?

(6) Does your company report information on credit card limits for all of the company's credit card accounts to each of the nationwide consumer reporting agencies?

Thank you in advance for your assistance in this matter.

Sincerely,

Melvin L. Watt, Chairman
Subcommittee on Oversight & Investigations
House Financial Services Committee

**Testimony of Jack Forestell, Senior Vice President of Card,**
**Capital One Financial Corporation**

**House Committee on Financial Services**
**Subcommittee on Oversight and Investigations**

**"What Borrowers Need to Know About Credit Scoring Models and Credit Scores."**
**July 29, 2008**

Chairman Watt, Ranking Member Miller and members of the Subcommittee, I greatly appreciate this opportunity to offer testimony on behalf of Capital One Financial Corporation for the record on the issue of credit scoring.

Capital One Financial Corporation (www.capitalone.com) is a financial holding company whose subsidiaries collectively had $92.4 billion in deposits and $147.2 billion in managed loans outstanding as of June 30, 2008. Headquartered in McLean, Virginia, Capital One has 740 locations in New York, New Jersey, Connecticut, Texas and Louisiana. It is a diversified financial services company whose principal subsidiaries, Capital One, N.A., Capital One Bank (USA), N. A., and Capital One Auto Finance, Inc., offer a broad spectrum of financial products and services to consumers, small businesses and commercial clients. Among its product lines, Capital One is one of the largest issuers of Visa and MasterCard credit cards in the world. A Fortune 500 company, Capital One trades on the New York Stock Exchange under the symbol "COF" and is included in the S&P 100 index.

Capital One applauds the Chairman and the Subcommittee for holding this hearing on a topic of great importance to American consumers, particularly at a time when economic conditions have become more challenging. For consumers, maintaining a strong credit rating is vital to ensuring their continued financial well-being through these difficult times. A strong credit rating has, in many ways, become a prerequisite to success in the modern economy, often playing a critical role in ensuring access not only to mortgages, credit cards, auto loans and other financial instruments, but also affordable insurance, rental housing and even employment.

**Financial Education**

As a diversified financial services company, Capital One continues to innovate and create new financial products and services that can vastly improve opportunities for many Americans. We strongly believe that it is in our best interest to ensure that our customers understand our products and services and make informed decisions that enable them to successfully manage their personal finances. As we continue to make improvements, we understand that information and education are essential. In this regard, it is imperative that consumers understand the nature and importance of credit scores.

To this end, at Capital One, we are committed to helping improve financial literacy skills in communities across the country and across the age spectrum. Through partnerships with leading non-profit organizations, Capital One has developed a multi-faceted set of programs to promote financial literacy and deliver financial education tools, particularly among low- and moderate-income populations. Many of our programs are designed to reach young people and teach them the fundamentals of money management that are critical to improving individual economic well-being.

Highlights of Capital One's comprehensive efforts to provide access to financial education and our innovative partnership efforts include:

***Junior Achievement***

Capital One partners with Junior Achievement (JA) on a number of initiatives intended to help prepare students from low- and moderate-income families to make smart financial decisions as adults.

- **Finance Park:** Capital One has an on-going partnership with Junior Achievement Worldwide –*Capital One/Junior Achievement Finance Park* – to introduce fifth through eighth-grade students to money management basics. This unique, mobile program travels to select cities to provide students the opportunity to experience a day-in-the-life of an adult. The goal is to prepare students to make wise financial decisions. Since 2006, more than 5,000 students have been reached by the program. We project more than 14,000 students will be reached in 2008 alone. We are especially proud that in Fairfax, Virginia, the Finance Park pilot has been adopted by Fairfax Public Schools. Beginning in 2009, every 8th grade student will participate in the financial education program as part of the required middle school curriculum.

- **JA in a Day:** Hundreds of Capital One associates delivered financial literacy education to every classroom in three elementary schools in Washington, D.C.

***MoneyWi$e Consumer Action Partnership***

Capital One partners with Consumer Action, a national non-profit organization dedicated to advancing consumer rights through education, to produce and distribute the *"MoneyWi$e"* series of financial education materials to consumers. The *MoneyWi$e* program includes informational brochures, train-the-trainer guides, and lecture curriculums.

One of our recent workbooks was designed to guide parents through the process of teaching their teens the basics of money management. The tool includes exercises ranging from how to plan a budget to how to write a check and, like all other MoneyWi$e materials, it is available at no cost on the Web (www.money-wise.org) and by mail. Among other issues, Capital One and Consumer Action partnership has also focused on the following topics:

- *General credit awareness and credit*
- *Homeownership and homebuyer awareness*
- *Military financial education*

- *Identity theft and fraud protection and awareness*
- *Elder fraud prevention*

Working with Consumer Action, Capital One has provided more than 1.5 million free brochures to consumers in five languages. In addition, the *MoneyWi$e* "train the trainer" seminars have been given to more than 450 community organizations, across 30 states.

***Branch Banking Financial Education***

Capital One Bank associates throughout the New York area conduct a range of financial education programs for local community members. The bank offers individual program modules targeted for elementary, middle school and high school-aged children and a program to teach basic banking to adults as part of workplace education initiatives.

- **Money Matters** is a four-week program that introduces elementary aged-children to the basic principles of managing money. The program includes three separate modules: one for grades 3 and 4; one for grades 4 and 5; and one for middle school.

- **Banking Tools for College and Life** addresses financial concerns at a critical point in students' lives. Capital One Bank associates emphasize to the students the seriousness of incurring debt. Students learn about the different types of credit and, perhaps even more importantly, how to protect themselves from identity theft.

- **Student Run Bank Branch**: In 2007, Capital One opened a bank branch at the Bronx-based Fordham Leadership Academy's Theodore Roosevelt Complex. The fully functioning branch is run by the Academy's seniors under the supervision of Capital One Bank management. The student bankers are participants in the Fordham Leadership Academy's Virtual Enterprise Program -- a business simulation program between the school and the business community. In its second year, the program provides an opportunity for select students to work with North Fork Bank to connect practical knowledge and skills learned in the Virtual Enterprise classroom with structured work outside the classroom.

***Jump$tart Coalition for Personal Financial Literacy***

Capital One is a proud sponsor of the Jump$tart Coalition's efforts to help ensure that basic money management skills are attained in American schools. Capital One has partnered with the Jump$tart Coalition to encourage the addition of basic personal financial management skills to the K-12 educational curriculum. Capital One also played a very active role in helping to form a Coalition in Virginia and has co-sponsored the Coalition's Annual Summit for the past two years.

***MoneyWi$e University***

To help give students the information they need to become financially responsible, Capital One has introduced MoneyWi$e University, a program to teach responsible spending and basic money management skills to college-aged students. Developed in partnership with Visa and first introduced on campuses in 2002, the MoneyWi$e University curriculum educates college students about the fundamental elements of credit and budget management. MoneyWi$e University has provided personal instruction to hundreds of students on five campuses across the

country. Information about *MoneyWi$e University* can be found online at www.moneywise-u.com.

Through our partnerships with leading national non-profit organizations, the volunteer efforts of Capital One associates and our grassroots approach to training non-profits to lead our programs on a local level, Capital One has established a broad and comprehensive approach to Financial Literacy. Additional information and links to all of our programs can be found at www.capitalone.com/financialeducation.

**Credit Scoring and Modeling**

Today, we are here to discuss how financial institutions develop and utilize credit scores and credit scoring models, as well as to discuss the protections we put in place to ensure that these scores and models accurately and fairly reflect the credit risk posed by our consumers. Like most financial institutions, Capital One uses a blend of internally derived and externally available consumer data to develop its own credit scoring models. Capital One prides itself, however, on using its highly sophisticated "Information Based Strategy" to help us identify, develop and offer the right product to the right consumer at the right time. Through this process, we believe that we can offer our customers a unique and beneficial range of products specifically tailored to their needs.

A critical component of this strategy hinges on Capital One's ability to manage risk prudently and effectively. Unlike the lending marketplace of old, where firmly entrenched local banking institutions dominated their communities and interacted with their customers often on a both a professional and personal level, institutions like Capital One may never meet the vast majority of its customers, particularly those outside of our branch network who carry our credit cards or auto loans.

This lack of personal contact has both advantages and disadvantages. One could be assured that the local banker of old knew much about his customer's financial status through a long-standing, deeply-rooted relationship, where a variety of factors played into any lending decision, including the customer's personal character or community standing. In some cases, however, inappropriate factors could influence a loan decision, including a customer's race or religion. In the modern marketplace, particularly with respect to national scale lending businesses such as credit cards, financial institutions often do not interact personally with their customers. A lender may not know much about an individual's "character" beyond what can be discerned about their past financial performance. Such lender, however, also know nothing about a customer's race, religion or other demographic data that, quite simply, should have no bearing on whether that customer receives a loan.

The above example illustrates a critical overarching point of context to any discussion on this topic. While we should endeavor to ensure that credit scoring is appropriately regulated and well understood by consumers, we should not forget that credit scoring models were developed precisely to combat some of the perceived downside risks of traditional lending, including racial and ethnic "red-lining." The strength of credit scores lies in their objectivity. The modern

financial services marketplace is a substantially more fair and equitable arena for all American consumers – one in which credit scores play a critical role in helping to ensure that individuals are judged on the merits of their actual financial performance.

The remainder of our testimony describes how Capital One develops and utilizes credit scores in its lending processes.

Capital One uses external credit scores and scores developed internally based on our own lending experience. In essence, both types of scores measure the probability that a borrower will repay a debt. We rely on those predictions to provide valuable credit to our customers while preserving the safety and soundness of Capital One as financial institution.

As you know, credit scoring, and use of customer data more broadly, is subject to a long-standing, extensive statutory and regulatory regime enacted by Congress and administered by the Federal Reserve, the other banking agencies and the Federal Trade Commission. The key statutes include the Fair Credit Reporting Act ("FCRA") and the Gramm-Leach-Bliley Act's privacy provisions ("GLBA"). Under these framework's, credit scores are given special privacy protections by Capital One. For example, we certify that we have a "permissible purpose" under the Fair Credit Reporting Act whenever we obtain scores and we strictly limit how we use and disclose those scores.

***Marketing***

Capital One uses credit data including credit scores in automated marketing models to make pre-approved offers of credit. This process, known as "prescreening," allows us to partner with credit bureaus to avoid marketing credit cards to populations less likely to be interested in them or unlikely to be approved.

The FCRA specifically authorizes prescreen marketing and creates requirements that we follow. For example, when we prescreen a consumer, we are required to extend a "firm offer of credit." In essence, a firm offer is one we will honor so long as the applicant continues to meet the criteria by which the consumer was selected. When we send a prescreened offer to a consumer, the credit bureaus record what is known as a "soft inquiry" on the consumer's credit file. Soft inquiries put consumers on notice that a lender has accessed the credit file, but they are never visible to other creditors and are not factored into credit scores. In other words, prescreen marketing does not negatively impact consumers' credit scores. Importantly, consumers who do not want prescreened offers have the right to opt out of prescreen marketing by contacting any one of the three nationwide consumer reporting agencies. The process for opting out is simple and is explained prominently in every written prescreened firm offer of credit.

***Underwriting***

Capital One uses credit data, including credit scores, in underwriting models. When an applicant responds to a prescreened offer, Capital One obtains a credit report to ensure that the applicant continues to meet the credit criteria for which he or she was selected. When a consumer seeks a non-prescreened offer of credit, for example, after reviewing card or other loan

products on our web page, Capital One obtains a credit report to see if the consumer qualifies for that product. In some instances, we may use the credit data to determine an appropriate loan amount or credit limit, the interest rate to be apllied, or to make a counteroffer of a different product if the consumer cannot be approved for the product for which he or she applied. Credit scores help us extend credit to a full range applicants, including those in underserved populations. In addition, using credit scores in conjunction with automated models makes our underwriting more efficient, which ultimately drives down the cost of credit for our customers.

***Account Review***

Capital One may consider credit scores, among other data, to manage the loans of existing customers. As we have testified on a number of occasions before this Committee and its counterpart in the Senate, Capital One does not use any form of "universal default" in our credit card business. Thus, we do not use bureau data in our decision to increase an existing customer's interest rate. We find that a customer's actual account performance with us – for example, their payment history – is a better predictor of their future performance than are bureau based credit scores.

Credit scores, however, do inform other of our account management practices, particularly those that allow us to improve our customers' terms as their credit profiles improve. For our credit card products, for example, credit scores enhance our ability to offer account upgrades such as removing an annual membership fee, reducing an annual percentage rate or offering rewards for purchases. We also consider credit scores as one factor among others in decisions to increase or decrease the amount of credit available to the customer.

**Fair Lending**

Capital One takes its obligations under the Equal Credit Opportunity Act ("ECOA") very seriously. We pride ourselves on developing the most sophisticated, and fair, credit scoring models in the industry. These models, and the processes we have put in place to ensure that only valid, appropriate criteria are used in our credit decisioning, are state of the art, and continuously evaluated to ensure they remain so.

Each factor, or variable, used in Capital One's internal credit models is evaluated for compliance with the ECOA, the Fair Housing Act and the FCRA among other laws through a review process known as Statistics Compliance and Legal Engagement or "SCALE." In this process, a fair lending expert reviews every variable to ensure that it is neither expressly prohibited by fair lending laws nor an obvious proxy for such a variable. An additional component of the SCALE process is an internally-developed computer program that incorporates current fair lending laws and legal advice in an easy-to-use decision tree that evaluates the variable itself along with its intended use for compliance with fair lending laws. The SCALE process has been thoroughly reviewed on multiple occasions by our federal regulators since its inception, and has received praise from our supervisors for its effectiveness. In fact, Capital One's primary bank regulatory, the Office of the Comptroller of the Currency

(OCC), has requested that Capital One discuss the process at the OCC's upcoming 2008 Fair Lending Conference -- Statistical Analysis and Modeling for Risk Assessment.

All Capital One associates involved in lending receive annual fair lending training through a sophisticated and comprehensive computer-based training module. Associates who work with credit scoring models receive additional classroom training on the SCALE process, taught by representatives from Capital One's compliance and legal departments.

For externally developed credit scores, Capital One requires its vendors to identify the types of variables included in their credit scoring models and to certify that the variables are not among those prohibited by fair lending laws. Capital One has declined to do business with companies that refused to follow these criteria.

**Other Sources of Data**

In assessing an applicant's creditworthiness, Capital One may consider information not available from credit bureaus and not factored in to credit scores. For example, Capital One may ask an applicant for household income or whether he or she has a checking or savings account. We use this information to determine whether the applicant meets certain pre-established eligibility requirements, such as debt-to-income ratio.

As discussed above, for account management purposes, Capital One relies predominately on our own account performance information, rather than credit data, to assess an existing customer's creditworthiness.

**Credit Bureau Reporting**

Capital One's practice is to report all data we believe to be relevant to the credit worthiness of our customers. We report this data to each of the nationwide consumer reporting agencies. This data includes loan balances, credit limits and payment history. Capital One seeks to report all such information in a manner that ensures the consistency, accuracy and integrity of the data. In this regard, we adhere to guidelines set forth in the Consumer Data Industry Association's *Credit Reporting Resource Guide*.

* * *

Chairman Watt, Ranking Member Miller, we thank you for this opportunity to provide testimony to your Subcommittee.

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

July 28, 2008

The Honorable Melvin L. Watt
Chairman
Subcommittee on Oversight & Investigations
House Financial Services Committee
United States House of Representatives
Washington, D.C. 20515

Dear Chairman Watt:

This responds to your letter of July 24, 2008 requesting that the Commission provide a written statement explaining how the FTC has implemented Section 212(b) of Title II of the Fair and Accurate Credit Transactions Act ("FACTA").

Section 212(b) of FACTA amended Section 609 of the Fair Credit Reporting Act ("FCRA") to provide consumers the right to obtain disclosure of their credit scores and related information from consumer reporting agencies ("CRAs"). Pursuant to Section 609(f)(8) of the FCRA, CRAs may charge a "fair and reasonable fee, as determined by the Commission" for such disclosure. The statute does not specify the manner in which the Commission should make its determination, nor set any time period by which the determination must be made.[1]

In November 2004, the Commission published an Advance Notice of Proposed Rulemaking ("ANPR"), copy attached, requesting public comment to inform its determination of a fair and reasonable fee.[2] The ANPR set out the legal background, described conditions in the credit score market at the time, and outlined possible advantages and disadvantages of various approaches that the Commission might use to reach its determination. The three principal approaches set forth in the ANPR were: (1) establishing a single mandatory price that

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[1] Consumers' right to purchase their credit score is in addition to their right to a free annual credit report from each of the nationwide CRAs.

[2] 69 FR 64698 (November 8, 2004).

regulated entities must charge for a credit score disclosure; (2) setting a maximum fee; or (3) making a market-based determination by periodically surveying the degree to which the market remained competitive and the fees remained reasonable.

With respect to the options of establishing a mandatory or maximum fee, the Commission stated that these approaches would provide clarity and certainty, but could impair competition in the industry and result in higher fees for consumers than a competitive market would generate. The Commission further noted that the statute only covers certain members of the credit score industry, and that a fixed price might place regulated sellers at a competitive disadvantage to unregulated sellers.

With regard to the market-based approach, the Commission stated that this option was "attractive because a competitive market generally provides the most rational, responsive, and efficient form of pricing."[3] The Commission characterized the market at that time as "extensive and dynamic," with many different types of credit scores available to consumers from many different companies at fees ranging from $4 to $8. The Commission stated that, absent additional Commission action by the effective date of the credit score disclosure requirement, its enforcement of the "fair and reasonable fee" provision would be by reference to the extant market in credit scores, and that it could question any fee that significantly exceeded the current market rates for credit scores.[4]

Since 2004, the Commission staff has continued to monitor the credit score market to evaluate whether it has remained competitive and has generated fees that are reasonable. Over that time period, the fee for credit scores has ranged from approximately $6 to $8. It appears that competition in the industry has remained robust, and that the range of prices for credit scores has remained fairly constant.

It is worth noting that consumers have, or will have, the ability to obtain credit score information at no charge in many instances. Under Section 609(g) of the FCRA, mortgage lenders and brokers that use credit scores from CRAs in considering loan applications are

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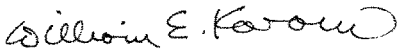
[3] 69 FR at 64700.

[4] The Commission received nearly 300 comments in response to the ANPR, although the vast majority were nonsubstantive. Of the few substantive comments, credit score sellers generally favored a market-based approach, while consumer groups favored a fixed or maximum fee. Laws in California and Colorado allow consumer to get their credit scores for a "reasonable" fee.

required to provide applicants with a free disclosure of those scores.[5] Additionally, as part of a recent settlement of a class action litigation against one of the three nationwide CRAs, TransUnion, most U.S. consumers will be entitled to six to nine months of free credit monitoring, which will include unlimited daily access to their TransUnion credit reports and credit scores.[6] Finally, under a rule recently proposed by the Commission and the Board of Governors of the Federal Reserve System, many consumers that apply for credit would receive a free credit score with explanatory information from creditors that engage in "risk-based pricing."[7]

In sum, competition in the credit score market has continued to be robust, with many different sellers offering scores for fees that remain in the range of $6 to $8. The Commission will continue to monitor the market to ensure that the fees remain reasonable, and will take further action as appropriate.

By direction of the Commission.



William E. Kovacic
Chairman

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[5] 15 U.S.C. § 1681g(g). If a mortgage lender uses a score obtained from an entity other than a CRA, however, it may provide either the actual score or a score obtained from a CRA for the purpose of providing a disclosure to the consumer. *Id.*

[6] *In re TransUnion Corp. Privacy Litigation,* Case No. 00-CV-4729 (U.S. Dist. Ct., N.D. Ill., Eastern Division May 28, 2008). The class includes all consumers who had an open credit account or an open line of credit from a credit grantor (*e.g.,* automobile loans, bank credit cards, department store credit cards, other retail store credit cards, finance company loans, mortgage loans, and student loans) located in the United States anytime from January 1, 1987 to May 28, 2008. This case followed on the settlement of a Commission law enforcement action against TransUnion alleging that TransUnion sold lists of consumer information to third parties for marketing purposes in violation of the FCRA.

[7] 73 Fed Reg 28966 (May 19, 2008). Under this proposed rule, creditors that price credit, in whole or in part, based on information in the consumer's credit file must either (1) provide a notice to those consumers who received materially less favorable terms, or (2) provide a free credit score to *all* of its applicants. The comment period on the proposed rule closes on August 18, 2008.

64698 Federal Register / Vol. 69, No. 215 / Monday, November 8, 2004 / Proposed Rules

**FEDERAL TRADE COMMISSION**

**16 CFR Chapter I**

**[RIN 3084–AA94]**

## Fair and Reasonable Fee for Credit Score Disclosure

**AGENCY:** Federal Trade Commission (FTC).

**ACTION:** Advance notice of proposed rulemaking, request for comment.

**SUMMARY:** Section 212(b) of the Fair and Accurate Credit Transactions Act of 2003 ("FACT Act") amends the Fair Credit Reporting Act ("FCRA") by adding a new section 609(f), which mandates that consumer reporting agencies make available upon request a consumer's credit score, together with other information. Section 609(f)(8) provides that a consumer reporting agency may charge a "fair and reasonable fee, as determined by the [Federal Trade] Commission" for such disclosure.

In this document, the Federal Trade Commission ("FTC" or "Commission") is publishing for comment an advance notice of proposed rulemaking that would implement the requirement in section 609(f)(8) of the FCRA that it determine a fair and reasonable fee to be charged by a consumer reporting agency for providing the information required under FCRA section 609(f).

**DATES:** Comments must be received by January 5, 2005.

**ADDRESSES:** Interested parties are invited to submit written comments. Comments should refer to "FACTA Credit Score Fee, Project No. R411004" to facilitate the organization of comments. A comment filed in paper form should include this reference both in the text and on the envelope, and should be mailed to the following address: Federal Trade Commission/ Office of the Secretary, Room H–159 (Annex O), 600 Pennsylvania Avenue, NW., Washington, DC 20580. The FTC is requesting that any comment filed in paper form be sent by courier or overnight service, if possible, because U.S. postal mail in the Washington area and at the Commission is subject to delay due to heightened security precautions.

Comments containing confidential material must be filed in paper form, must be clearly labeled "Confidential," and must comply with Commission Rule 4.9(c). 16 CFR 4.9(c) (2004).[1]

Comments filed in electronic form should be submitted by clicking on the following Web link: *https://secure.commentworks.com/ftc-CreditScoreFee* and following the instructions on the Web-based form. To ensure that the Commission considers an electronic comment, you must file it on the Web-based form at the *https://secure.commentworks.com/ftc-CreditScoreFee* weblink. You may also visit *http://www.regulations.gov* to read this advance notice of proposed rulemaking, and may file an electronic comment through that Web site. The Commission will consider all comments that regulations.gov forwards to it.

The FTC Act and other laws the Commission administers permit the collection of public comments to consider and use in this proceeding as appropriate. All timely and responsive public comments received by the Commission, whether filed in paper or in electronic form, will be considered by the Commission, and will be available to the public on the FTC Web site, to the extent practicable, at *http://www.ftc.gov*. As a matter of discretion, the FTC makes every effort to remove home contact information for individuals from public comments it receives before placing those comments on the FTC Web site. More information, including routine uses permitted by the Privacy Act, may be found in the FTC's privacy policy, at *http://www.ftc.gov/privacy.htm*.

**FOR FURTHER INFORMATION CONTACT:** Christopher Keller, Attorney, (202) 326–3224, Division of Financial Practices, Federal Trade Commission, 601 New Jersey Avenue, NW., Washington, DC 20580.

**SUPPLEMENTARY INFORMATION:**

### I. Background

The FCRA, enacted in 1970, sets standards for the collection, communication, and use of information bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living that is collected and communicated by consumer reporting agencies. 15 U.S.C. 1681–1681x. Since its inception in 1970, the FCRA has provided generally that a consumer may learn of the information that consumer reporting agencies maintain concerning the consumer. As originally enacted, the FCRA provided that a consumer could obtain disclosure of the "nature and substance" of the information in his or her file at the consumer reporting agency.

In 1996, the Consumer Credit Reporting Reform Act, Pub. L. 104–208, 110 Stat. 3009, amended the FCRA to provide that a consumer may obtain disclosure of "[a]ll information in the consumer's file at the time of the request * * *," as well as a summary of consumer rights under the FCRA. However, the 1996 amendment specifically excluded from the information required to be disclosed to consumers "any information concerning credit scores or any other risk scores or predictors relating to the consumer."

The Fair and Accurate Credit Transactions Act of 2003, Pub. L. 108–159, 117 Stat. 1952, amends the FCRA to add a new subsection 609(f) to the FCRA, giving consumers the right to obtain disclosure of credit scores and related information.[2] The requirement to disclose a credit score applies to consumer reporting agencies that "distribute scores that are used in connection with residential real property loans," or "develop scores that assist credit providers in understanding the general credit behavior of a consumer and predicting the future credit behavior of the consumer."[3] The provision requires only the disclosure of a "mortgage score" or "educational score," and does not require disclosure of other risk scores based on credit information, such as those used to underwrite auto loans, personal loans, credit cards, or insurance products.[4]

[1] The comment must be accompanied by an explicit request for confidential treatment, including the factual and legal basis for the request, and must identify the specific portions of the comment to be withheld from the public record. The request will be granted or denied by the Commission's General Counsel, consistent with applicable law and the public interest. See Commission rule 4.9(c), 16 CFR 4.9(c).

[2] In relevant part, Section 212(b) of the FACT Act provides:

(b) DISCLOSURE OF CREDIT SCORES—Section 609 of the Fair Credit Reporting Act (15 U.S.C. 1681g), as amended by this Act, is amended by adding at the end the following:

"(f) DISCLOSURE OF CREDIT SCORES—

"(1) IN GENERAL—Upon the request of a consumer for a credit score, a consumer reporting agency shall supply to the consumer a statement indicating that the information and credit scoring model may be different than the credit score that may be used by the lender, and a notice which shall include—

"(A) the current credit score of the consumer or the most recent credit score of the consumer that was previously calculated by the credit reporting agency for a purpose related to the extension of credit;

"(B) the range of possible credit scores under the model used;

"(C) all of the key factors that adversely affected the credit score of the consumer in the model used, the total number of which shall not exceed 4 * * *;

"(D) the date on which the credit score was created; and

"(E) the name of the person or entity that provided the credit score or credit file upon which the credit score was created."

[3] FCRA section 609(f)(4).

[4] Section 609(f)(7)(A) provides that "In complying with this subsection, a consumer reporting agency shall supply the consumer with [1] a credit score

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New subsection 609(f)(8) provides that the consumer reporting agency may charge a "fair and reasonable fee, as determined by the Commission" for such disclosure.

New section 609(f)(2)(A) of the FCRA defines a credit score as "a numerical value or a categorization derived from a statistical tool or modeling system used by a person who makes or arranges a loan to predict the likelihood of certain credit behaviors, including default." Generally, the higher the score, the lower the predicted risk.[5]

Currently, there appears to be an extensive and dynamic market for credit score products. In addition, several sellers are developing and introducing diverse new scoring products. Many of these sellers are not consumer reporting agencies, and thus would not be subject to the Commission's fee determination under FCRA section 609(f)(8). Consumers can buy scores from several companies, including subsidiaries of nationwide consumer reporting agencies and Fair Isaac and Company (FICO), the company that initially developed credit scoring. Other companies have also entered the market.[6]

Scores are available to consumers in a wide variety of forms and delivery methods, both directly from the companies that provide the scores and score products themselves, and indirectly through entities that have existing relationships with consumers (*e.g.*, credit card issuers) who "partner" with the score suppliers. Some companies that offer consumer credit scores also provide a variety of educational material, including tutorials and interactive exercises that allow consumers to see how modifications in credit behavior (such as closing an account or making a larger payment) might affect their credit score.[7]

Most credit score products available to consumers include not only a score, but also a copy of the consumer's complete credit report and educational materials.[8] Some products include additional features, such as a monitoring function—*e.g.*, a service that alerts the consumer when new or negative information is added to the consumer's file or new accounts are opened in the consumer's name.[9] The "bundled" services are available at prices that range from $14 to $90, depending on the duration of the service and the range of options offered with the package. For those packages that include only the consumer's full report plus a score, the incremental cost of the score component of the product appears to be in the range of $4 to $7.[10]

Stand-alone scores, such as those required by section 609(f), appear to be available in those states that mandate free credit reports, and particularly in California and Colorado, where state laws require the disclosure of credit scores.[11] In California and Colorado, the laws requiring disclosure of scores also permit a consumer reporting agency to charge a "reasonable" fee.[12] In those states where a score-only product is available, the cost range is approximately $5 to $8.[13]

## II. Possible Approaches for Commission Determination

Section 609(f)(8) of the FCRA states that consumer reporting agencies may charge a fair and reasonable fee "as determined by the Commission." The law does not specify the manner in which that fee is to be determined. The Commission invites comments from all interested parties on any aspect of a proposed determination of a fair and reasonable fee for score disclosure. In setting out its background discussion above, and in reviewing various potential approaches to its determination below, the Commission does not wish to preclude comment on any alternatives, or the submission of appropriate background information. The Commission invites comment on approaches and factors that should be considered in determining a fee for the disclosures required under FCRA section 609(f), as well as comment on underlying premises that it should employ in considering various approaches and factors.

There are several possible approaches that the Commission could take to make the required determination. One approach would be to establish a single mandatory price that regulated entities must charge for a score disclosure. Such an approach could provide clarity and certainty for both the industry and consumers. On the other hand, a fixed price might result in a higher fee than a consumer would be asked to pay in a competitive market; where the price is set above the level the regulated seller would otherwise charge, consumers could pay more than they would without intervention. If the fee is set too low, however, it may discourage competition on other terms of the transaction. For example, the seller may choose to cut corners elsewhere, such as quality, service, or willingness to innovate. In a market such as this—with both regulated sellers (consumer reporting agencies who distribute mortgage scores or develop their own scoring models) and unregulated sellers (non-consumer reporting agencies and consumer reporting agencies that do not sell mortgage scores or develop proprietary scores)—a fixed price may place regulated sellers at a competitive disadvantage to unregulated sellers.

A maximum fee is another potential approach (setting a "cap" or upper limit on the fee that could be charged). A maximum fee may be preferable to a mandatory fee because it would allow

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that is derived from a credit scoring model that is widely distributed to users by that consumer reporting agency in connection with residential real property loans or [2] with a credit score that assists the consumer in understanding the credit scoring assessment of the credit behavior of the consumer and predictions about the future credit behavior of the consumer." Section 609(f)(7), 15 U.S.C. 1681g(f)(7). Thus, consumer reporting agencies may provide consumers with a score derived from an actual model used to calculate scores for mortgage underwriting, or may opt to provide consumers with a so-called "educational score," which shows a consumer how scoring works and the perceived credit risk that the consumer presents relative to other consumers.

[5] *See http://www.ftc.gov/bcp/creditscoring/present/index.htm* (describing the development and application of scoring models). Section 212(c) of the FACT Act ("Disclosure of Credit Scores by Certain Mortgage Lenders"), which adds subsection (g) to section 609 of the FCRA, specifies the text of an educational disclosure notice that mortgage lenders are required to supply to consumers. The notice describes how scores are derived and explains their significance to the consumer. Section 609(g)(1)(A) and (D); 15 U.S.C. 1681g(g)(1)(A), (D).

[6] For example, in April 2004, Intersections, Inc., a company specializing in providing various credit information products direct to consumers, made an initial public offering of common stock. *See American Banker*, "Young Credit Monitoring Firm Gets Cap One Feather in Cap," Sept. 15, 2004.

[7] *See, e.g., http://www.myfico.com/*

[8] *See, e.g., http://www.transunion.com/; http://www.experian.com/; https://www.econsumer.equifax.com/; http://www.freecreditadvice.com/; http://www.consumerinfo.com/; http://www.truecredit.com/.*

[9] *See, e.g., http://www.freecreditreport.com/.*

[10] We look only at report-plus-score products because where the "bundle" includes added services or products, the cost of the additional items would be difficult to ascertain. The score component calculation is based on an assumption that, of the total fee for the package, the basic cost of the full credit report accounts for approximately $9, which is the price generally charged by consumer reporting agencies for a stand-alone copy of a consumer report.

[11] Sections 1785.10 and 1785.15.1 of the California Civil Code, effective July 1, 2001; Section 12–14.3–104.3 of the Colorado Revised Statues. Section 212(b) of the FACT Act is based on the California statute.

[12] Section 1785.15.2(b) of the California Civil Code, and section 12–14.3–104.3(5) of the Colorado Revised Statutes, respectively. Although the statutes permit consumer reporting agencies to charge a "reasonable fee," they do not specify a fee or a mechanism for determining one.

[13] TransUnion offers a stand-alone score for $4.95 through its Web site. *See http://www.transunion.com/Personal/CreditReportandScoreFees.jsp.* Based on telephone inquiries in California made in mid-2004, Experian sells a score alone for $6, and Equifax charges $8.

regulated entities to compete on price.[14] If the price cap is set below the level the regulated seller would otherwise charge, however, it shares many of the drawbacks of a mandatory price. Furthermore, as academic commenters have recognized, a maximum price can become a de facto mandatory price.[15] For example, the nine-dollar maximum fee specified in the Fair Credit Reporting Act's section 609(f) for the disclosure of consumer report information to consumers has become, in practice, the industry norm: the three major nationwide consumer reporting agencies all charge $9 for consumer file disclosures, despite the opportunity to compete on price below the statutory limit.

Moreover, any set fee, whether mandatory or maximum, runs the risk of becoming obsolete.[16] A set fee may become too low—*e.g.*, if the costs of producing or delivering a score rise; or it may become too high—*e.g.*, if new technology lowers the costs of selling a score or if market participants would compete on price absent the regulation.

Some of these problems may be addressed by adjusting the set price periodically by a preannounced external factor—*e.g.*, the consumer price index. There is a variety of ways in which such adjustments might be undertaken—they could be automatic and required within any rule that the Commission adopts as its determination, or they could be initiated by the Commission in the context of periodic review of its determination. If the adjustments were automatic, the Commission could itself make the adjustment based on preannounced criteria,[17] or it could provide a formula for periodic adjustment that those subject to the rule would be required to apply and implement.

One limitation to the usefulness of an externally-derived price adjustment is the fact that it would not take into account possible changes, *e.g.*, in technology or costs, that are internal to a specific firm or the industry. In order to account for such changes, the Commission could readjust fees based on an examination of the internal operations of each individual firm. In the public utility context, this is typically done by a detailed examination of a firm's operating costs and profits, capital employed, cost of capital, and rate of return on capital. Of course, this would be a potentially difficult and complex inquiry for the Commission to undertake in this proceeding, especially because it may be difficult to specify which cost elements should be included in the calculations or how to allocate fixed costs, such as the cost of developing the scoring model.

Another approach that the Commission might consider would be to make a determination that looks to those charges produced by a competitive market as the basis for a fair and reasonable fee. Such a determination might be done with varying degrees of Commission involvement. For example, the Commission might conduct a periodic market survey to determine the range of prices charged and whether those prices are the product of competition, and set a price or a range of prices.

A market-based approach is attractive because a competitive market generally provides the most rational, responsive, and efficient form of pricing. Typically, the market is able to produce and account for relevant factors: prices, quality, service, costs, encouragement of investment, and promotion of competition. The government often sets cost-based fees in the public utility context, because regulators often have no competitive market to which they can refer. In the case of direct-to-consumer credit scores, however, there currently exists a market with many buyers and sellers on which the Commission might base a determination. In its consideration of whether a market-based determination is appropriate and feasible, the Commission seeks comment on whether there is reason to believe that the fees being charged consumers for credit scores today are not fair and reasonable, that there is not active price competition, or that the market is not producing appropriate pricing incentives.[18]

More specifically, the Commission seeks comment on an appropriate methodology for determining a fair and reasonable fee if it elected a market-based approach. One method that the Commission might consider would take advantage of the market in credit scores by determining a fee that fluctuates based on that market. For example, the Commission's survey of the market to be regulated shows that prices between $5 and $8 currently are charged.[19] A determination that reflects a dynamic, competitive market might include a set or maximum fee based on a calculated weighted mean figure. This approach could require the fee to be readjusted as the weighted mean price for credit scores rises and falls. If the Commission adopted such an approach, it would need to specify whether the Commission itself would make such market-based readjustments, or whether affected parties would be required to determine and apply readjustments based on a Commission-supplied formula.

The Commission also seeks comment on whether a fee determination based on ongoing assessment of the market might be an appropriate method on which to base its determination, and also whether such an approach might have drawbacks. Any market-based approach assumes that the market in direct-to-consumer credit scores will persist. The Commission seeks comment on both the current state of the market for credit scores and anticipated changes in the market. For example, a factor that could lead to changes in market forces is consumers' new right under the FACT Act to obtain a free annual copy of their consumer reports from each of the nationwide consumer

[14] "[C]utting prices in order to increase business is often the very essence of competition." Matsushita Elec. Industrial Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986).

[15] *See, e.g.*, Scherer, *Industrial Market Structure and Economic Performance* at 190–93, 204 (1980); Scherer, "Focal Point Pricing and Conscious Parallelism," in Scherer, *Competition Policy, Domestic and International*, at 89–97 (2000). Although uniform prices might be the result of collusion, the outcome also can be due more innocently to a phenomenon sometimes referred to as "focal point pricing." In this situation, competitors in a market coalesce around an externally imposed "focal point," such as a government price control. *See also Arizona* v. *Maricopa County Med. Soc.*, 457 U.S. 332, 348 (1982) (stating that a maximum price fixing agreement "may be a masquerade for an agreement to fix uniform prices, or it may in the future take on that character").

[16] "The reasonable price fixed today may through economic and business changes become the unreasonable price of tomorrow." *United States* v. *Trenton Potteries Co.*, 273 U.S. 392, 397 (1927).

[17] Such an adjustment procedure would be analogous to the statutory adjustment, undertaken annually by the Commission, to the fee that consumer reporting agencies can charge consumers for disclosure of their credit files. (In 1996, Congress specified an $8 "cap" on the fee that consumer reporting agencies can charge for full-file disclosure to consumers. Section 612(a)(1)(A)(i) of the FCRA, 15 U.S.C. 1681j(f)(1)(A)(i). FCRA section 612(f)(2) provides that the Federal Trade Commission shall increase the amount based proportionally on changes in the Consumer Price Index. The current limit is $9. See *http://www.ftc.gov/os/2002/12/fedcreditstatutesfrn.htm.*).

[18] While there seems to be little variation in the price of the underlying consumer credit file that is being scored, which as noted is capped currently at $9, the several participants in the market appear to compete vigorously in other aspects of the direct-to-consumer score package (*e.g.*, the score itself, accompanying educational materials, and follow-up services). Furthermore, there is price dispersion in the market for bundled scores, as well as the market for stand-alone scores. *See supra* notes 7–13 and accompanying text (the current range for bundled scores is $4 to $7 and the current range for stand-alone scores is $5 to $8).

[19] Prices for credit scores appear to range between $4 and $7 in the unregulated market.

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reporting agencies through a "centralized source."[20] Nationwide consumer reporting agencies may choose to market scores to consumers (and may choose to fulfill their statutory obligation under section 609(f)) through the centralized source.[21] The centralized source may increase demand for scores by promoting consumer awareness of score availability, and might further competition among the nationwide consumer reporting agencies that sell scores through the centralized source. On the other hand, the centralized source might provide a competitive advantage to these consumer reporting agencies vis-a-vis other sellers of scores due to the "captive" audience of consumers that it supplies.[22]

The Commission is seeking to make a determination that would preserve for consumers the benefits of competition in both the regulated and unregulated market, while protecting consumers from the non-competitive prices that might occur in these markets in the event that competition deteriorates. Optimally, the Commission seeks to identify and implement an approach that will result in a fee that is fair to consumers; will provide regulated entities with a sufficient level of certainty; will encourage regulated entities to compete on price, quality, and service; will encourage innovation and cost-cutting; will avoid unduly interfering with the unregulated market for credit scores; and does not involve a lengthy rate-making proceeding or reliance upon proprietary cost or revenue data.

The Commission seeks comment on the relative merits of each approach, as well as comments and suggestions on other appropriate factors to take into account in determining a fair and reasonable fee or periodically adjusting that fee.

[20] Section 211(d) of the FACT Act. Under the Commission's rule implementing this requirement, this centralized source will first be available to some consumers beginning December 1, 2004, with full implementation by September 1, 2005. *See* 16 CFR 610, 69 FR 35466 (June 24, 2004). *See also http://www.ftc.gov/os/2004/05/040520factafm.pdf and http://www.ftc.gov/os/2004/06/040624factafreeannualfm.pdf.*

[21] *Id*

[22] The FACT Act also contains a new requirement that mortgage lenders disclose a credit score to home loan applicants, along with an explanatory notice. Section 212(c) of the FACT Act adds new FCRA section 609(g), effective December 1, 2004, mandating score disclosure and providing the text of the educational "Notice to the home loan applicant." This mandated disclosure and notice may increase consumer awareness of credit scores, which might increase consumer demand for scores, but also could diminish demand for score purchases, because those consumers who apply for home loans will receive scores for free.

*Effective Date*

The Commission proposes an effective date of thirty days after promulgation of its final determination.

The Commission recognizes that the provisions of FCRA section 609(f) will become effective on December 1, 2004 without regard to whether the Commission has made a determination or given guidance on how it will determine whether a particular fee is fair and reasonable.[23] Although Congress has directed credit scores be available for a fair and reasonable fee as determined by the Commission, it did not impose a deadline for a determination nor has it required that the determination be made in any particular manner. Furthermore, there is no indication that Congress meant to require regulated entities to make the required disclosures free of charge. For these reasons, the Commission interprets section 609(f) to allow regulated entities to charge a fee for required disclosures in advance of any specific Commission determination or other guidance, so long as that fee is fair and reasonable. Thus, absent additional Commission action on or before December 1, 2004, consumer reporting agencies must disclose mortgage or educational scores to consumers and may charge a fair and reasonable fee for those disclosures. Indeed, this process is currently used in the states that require similar disclosure.

The Commission's enforcement of the "fair and reasonable" requirement will be by reference to the extant market in credit scores. Thus, at present the Commission may question any fee that significantly exceeds the current market rates for credit scores, which are currently in the range of $4 to $8.

**III. Request for Comments**

The Commission welcomes comment on all aspects of the determination it will make, including policy and pragmatic considerations associated with any potential approach to determining a fair and reasonable fee for credit score disclosure, costs and benefits to all affected parties, implementation considerations, and any other issues bearing on the Commission's determination. Specifically, the Commission seeks comment on the range of approaches outlined above, as well as suggestions for alternative approaches to fee determination, and comments prompted by the following considerations and questions. All comments should be filed as prescribed in the **ADDRESSES** section above, and must be received by January 5, 2005.

(1) The Commission believes that the current market in direct-to-consumer scores is competitive and healthy—there appears to be price dispersion, innovation, and a variety of products and sellers. Is this an accurate characterization of the market? If so, why? If not, why? The Commission believes that one nationwide consumer reporting agency—TransUnion—sells stand-alone credit scores to consumers for $4.95 in states that mandate free file disclosures. Three nationwide consumer reporting agencies sell stand-alone scores in California and Colorado for prices ranging from $4.95 to $8. Is this accurate? Are these the only circumstances under which consumers can obtain stand-alone credit scores? The Commission believes that most scores are sold as part of a package or are bundled with a consumer report and other information or services. Is this accurate? What is the range of prices for these products? By what method should the score component of a package or bundle or goods and services be valued?

(2) The Commission recognizes that its determination under FCRA Section 609(f) will apply only to a portion of the market—consumer reporting agencies that distribute "mortgage" scores or develop their own credit scores—and only to two scoring products currently offered to consumers—"mortgage" scores and "educational" scores. How many consumer reporting agencies would be subject to this requirement? What percentage of the credit score market would be regulated, and what percentage unregulated?

(3) The Commission is aware that many non-consumer reporting agencies offer scores and related products to consumers. What is the relevant market for purposes of the Commission determination? What would be the competitive effects of the imposition of a maximum price requirement that applies only to a part of the market for scores? Would a maximum price requirement in the limited market for "statutory" scores (*i.e.*, mortgage or educational scores provided by consumer reporting agencies) have effects on the broader, unregulated market for scores?

(4) It is the Commission's understanding that many consumer reporting agencies do not currently provide scores directly to consumers, but do so through non-consumer reporting agency subsidiaries. Will consumer reporting agencies choose to fulfill the statutory requirement in

[23] See 16 CFR 602.1(c)(3)(x) (establishing December 1, 2004 as the effective date for FACTA Section 212(b)).

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FCRA Section 609 through non-consumer reporting agency subsidiaries?

(5) Consumer reporting agencies can fulfill FCRA Section 609's requirement by providing consumers with mortgage or educational scores. How will consumer reporting agencies choose to fulfill this requirement and what type of score are they most likely to provide to consumers? Why?

(6) Among the potential approaches available to the Commission is determining a fee based on the market for scores. In that context, what is the appropriate market to consider: the market for stand-alone mortgage and educational scores sold by consumer reporting agencies, or the market for all credit scores sold by consumer reporting agencies and non-consumer reporting agencies? If a market-based approach is appropriate, are these two markets appropriate reference points? Are there other markets that should be considered? Overall, what is the appropriate market, and what are the factors that the Commission should consider in determining the appropriate market?

(7) The Commission welcomes comment on whether other factors, in addition to prices charged in a competitive market, should be taken into account in determining a fair and reasonable fee for required disclosures (*e.g.*, cost data, revenue data, other market conditions). Comments should discuss the pragmatic aspects of each factor advanced for consideration; for example, whether data underlying a given factor are readily available or difficult to obtain.

(8) For any determination involving a specified dollar amount for a fair and reasonable fee, should the Commission include within a final determination a mechanism for periodic adjustment of the specified amount? If so, what approach is desirable for such adjustment and what entity or entities should determine the specific adjustment? Should the Commission initiate new assessments of all of the factors underlying its determination at a fixed time interval, or only when a factor changes significantly? Should the Commission's determination include an "automatic" adjustment keyed to the consumer price index or similar economic index? Should periodic adjustments be required to be both determined and implemented by the regulated entities based on a formula set forth within the Commission's determination? Are there other bases for periodic adjustment that might be appropriate?

By direction of the Commission.

Donald S. Clark,

*Secretary.*

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## SOCIAL SECURITY ADMINISTRATION

**20 CFR Part 404**

**[Regulation No. 4]**

**RIN 0960-AF28**

## Revised Medical Criteria for Evaluating Impairments of the Digestive System

**AGENCY:** Social Security Administration.

**ACTION:** Proposed rules; limited reopening of comment period.

**SUMMARY:** We are reopening for limited purposes the comment period for the notice of proposed rulemaking (NPRM) that we published in the **Federal Register** on November 14, 2001 (66 FR 57009). We have decided to reopen the comment period for 60 days to solicit additional public comments on our proposal to revise and remove several of the chronic liver disease listings from the Listing of Impairments (the listings) because we believe that the revisions we propose are significant. We are reopening the comment period only to accept comments about chronic liver disease. Due to the limited reopening of the NPRM, we will not consider any comments on other aspects of the proposed listings for the digestive system.

**DATES:** To be sure your comments are considered, we must receive them by January 7, 2005.

**ADDRESSES:** You may give us your comments by: using our Internet site facility (*i.e.*, Social Security Online) at: *http://policy.ssa. gov/pnpublic.nsf/LawsRegs* or the Federal eRulemaking Portal at *http://www.regulations.gov;* e-mail to regulations@ssa.gov; telefax to (410) 966-2830; or by letter to the Commissioner of Social Security, P.O. Box 17703, Baltimore, Maryland 21235-7703. You may also deliver them to the Office of Regulations, Social Security Administration, 107 Altmeyer Building, 6401 Security Boulevard, Baltimore, Maryland 21235-6401, between 8 a.m. and 4:30 p.m. on regular business days. Comments are posted on our Internet site, at *http://policy.ssa. gov/pnpublic.nsf/LawsRegs* or you may inspect them on regular business days by making arrangements with the contact person shown in this preamble.

Electronic Version: The electronic file of this document is available on the date of publication in the **Federal Register** at *http://www.gpoaccess. gov/fr/index.html.* It is also available on the Internet site for SSA (*i.e.*, Social Security Online) at: *http://policy.ssa. gov/pnpublic.nsf/LawsRegs.*

**FOR FURTHER INFORMATION CONTACT:** Suzanne DiMarino, Social Insurance Specialist, Office of Regulations, Social Security Administration, 107 Altmeyer Building, 6401 Security Boulevard, Baltimore, Maryland 21235-6401, (410) 965-1767 or TTY (410) 966-5609. For information on eligibility or filing for benefits, call our national toll-free number, 1-800-772-1213 or TTY 1-800-325-0778, or visit our Internet Web site, Social Security Online, at *www.socialsecurity.gov.*

**SUPPLEMENTARY INFORMATION:** On November 14, 2001, we published "Revised Medical Criteria for Evaluating Impairments of the Digestive System" as an NPRM in the **Federal Register** (66 FR 57009). You may find this document at our Web site: *http://policy.ssa.gov/erm/rules.nsf/5da82b031 a6677dc85256b41006b7f8d/ a37bb476cb 227bdd85256b410067a74d?OpenDocument.*

This NPRM proposed to revise the criteria in the Listings that we use to evaluate claims involving impairments of the digestive system. We explained in the proposed rules that we were revising and removing several of the chronic liver disease listings because of the progress in medical and surgical advancements in treating these diseases. When we published the NPRM, we provided a 60-day comment period that ended January 14, 2002. We have reviewed and considered all the comments we received during the comment period. However, we received few comments regarding our proposed revisions to the listings that specifically involve chronic liver disease. Because we believe that the revisions we propose are significant, we want to ensure that the public has another opportunity to review and comment on those proposals involving the evaluation of chronic liver disease. In order to allow the public sufficient time to review and comment on our proposals, we have decided to provide an additional 60-day comment period within which to comment on our proposal to revise and remove several of the listings for evaluating chronic liver disease. If you have already provided comments on the proposals, your comments will be considered and you do not need to resubmit them.

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Statement submitted by

Sandra F. Braunstein, Director,
Division of Consumer and Community Affairs

Board of Governors of the Federal Reserve System

to the

Subcommittee on Oversight and Investigations

Committee on Financial Services

U.S. House of Representatives

July 29, 2008

The Board of Governors of the Federal Reserve System (Board) is pleased to have this opportunity to address the nexus between the efforts of the Board to combat credit discrimination and the use by lenders of credit scoring systems to evaluate consumers' credit risk. Specifically, we appreciate the opportunity to outline the findings of the Board's report on credit scoring and its effects on the availability and affordability of credit, and how this report further informs ongoing efforts to prevent impermissible factors from being considered in the credit evaluation process.

There are three aspects of the Board's role relating to fair lending and credit scoring systems. First, as a rule writer, the Board has issued Regulation B, which implements the Equal Credit Opportunity Act (ECOA). Regulation B prohibits discrimination against credit applicants on any prohibited basis (such as race, national origin, age, or sex). Regulation B also addresses the use of prohibited bases in credit scoring systems. Second, as a supervisor of financial institutions, the Board conducts fair lending examinations to ensure that financial institutions comply with ECOA and other applicable fair lending laws, and takes enforcement action when it finds violations. Third, as research institutions, the Board and Reserve Banks study significant trends in the credit market, such as the use of credit scores and credit scoring models, publishes their research, and encourage research by other parties as well.

## I. Background on Credit Scoring Systems and ECOA

### *A. Credit Scoring Systems*

Credit scoring is a statistical methodology that quantifies the credit risk--the likelihood of nonpayment or default--posed by a prospective or current borrower. The prevalence of credit scoring systems has increased significantly over the past two decades. Today, credit scoring is widely used to underwrite and price all types of consumer credit, such as mortgage loans, auto

loans, and credit cards. When used appropriately, credit scoring can increase the objectivity and consistency of the credit evaluation process. Credit scoring also has increased access to credit for consumers, enhanced competition, and decreased costs for lenders.

At the same time, the growing use of credit scoring has been accompanied by concerns about its potential negative effect on fair access to credit, especially for women and minorities. In recognition of these concerns, Congress directed the Board to study how credit scoring has affected the availability and affordability of credit, to determine the relationship between credit scores and actual credit losses, and to determine how these relationships vary for the population groups protected under ECOA.[1] In addition, Congress directed the Board to study the extent to which consideration of certain factors included in credit scoring systems could have a negative effect on protected populations, and the extent to which alternative factors could achieve comparable results with less negative effect.

There are little data available linking credit scores to relevant demographic information. As a result, there has been limited research on credit scoring and its effect on credit markets or protected segments of the population. For this reason, the findings of the Board's report, which are based on the unique research conducted by the Board staff specifically for this study, are significant.

*B. ECOA and Credit Scoring Systems*

ECOA, enacted in 1974, generally prohibits creditors from discriminating against a credit applicant on a prohibited basis (such as race, national origin, religion, age, or sex) in a credit

[1] In Section 215 of the Fair and Accurate Credit Transactions Act of 2003 (FACT Act), Congress directed both the Board and the Federal Trade Commission (FTC) to study the effect of credit scoring on the availability and affordability of financial products and report on their findings. The Board focused on studying the effects of credit scoring on credit markets, reporting its findings in August 2007. See Board Report to Congress, *Credit Scoring and Its Effects on the Availability and Affordability of Credit* (August 2007). The FTC focused on the effects of credit scoring in the area of insurance and issued a separate report on automobile insurance in July 2007, and is preparing a separate report on homeowner's insurance. See FTC Report to Congress, *Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance.*

transaction. ECOA covers business credit, as well as consumer credit. Lenders are prohibited by ECOA from using credit scoring systems that take into account any prohibited basis under ECOA, except for age. For example, a lender is not permitted to use a credit scoring system that considers race or gender to evaluate the creditworthiness of an applicant.

ECOA is implemented by the Board's Regulation B. In 1977, the Board adopted rules under Regulation B to implement the ECOA's provision permitting lenders to consider age in limited circumstances. Thus, Regulation B allows lenders to consider age as a predictive factor in an empirically derived, demonstrably and statistically sound, credit scoring system ("validated system").[2] Any system that does not qualify as a validated system is classified as a judgmental system under Regulation B. In judgmental systems, lenders are limited to considering age only for the purpose of determining a "pertinent element of creditworthiness." For example, age may not be considered directly, but can be used if it relates to other information used to evaluate creditworthiness, such as to assess the significance of length of employment (a young applicant that recently entered into the job market) or residence (an elderly applicant that recently retired and moved from a long-term residence).

Regulation B establishes the criteria for qualifying a credit scoring system as a validated system. A credit scoring system is a validated system for purposes of Regulation B if it is (1) based on empirical data that compares sample groups or actual populations of creditworthy and non-creditworthy applicants within a reasonable time period, (2) developed to calculate the credit risk of applicants for legitimate business purposes, (3) validated using accepted statistical methods, and (4) subject to periodic revalidation meeting the same standards.

[2] Under ECOA and Regulation B, a lender can consider age to ensure the applicant has the capacity to contract. In addition, under Regulation B, a lender can consider age when it is used more favorably towards a credit applicant age 62 or older. For example, if a lender assigns "points" to applicants in its credit scoring system, a credit applicant 62 years or older must receive the same or a greater number of points than a younger applicant when calculating the credit score.

Regulation B does not stipulate how often lenders must revalidate these systems to ensure the accuracy of their predictive ability, but provides that it should be frequent enough to continue to meet recognized professional statistical standards for statistical soundness. For example, periodic review of a system's performance could include analyzing shifts in a lender's customer base to detect deviations from the applicant population used to validate the system. Regulation B also explicitly permits lenders to use validated systems that are developed by third-parties. However, lenders retain responsibility for ensuring that these systems meet the criteria set forth in Regulation B.

It is important to note that although Regulation B prohibits inclusion of certain factors, it does not require that a lender assign a particular weight or value to data that can be permissibly used in a credit scoring system. In addition, Regulation B does not prescribe the method of credit analysis a lender must use, unless age is used as a predictive variable in evaluating the creditworthiness of an applicant (in which case a lender must use a validated system). However, even when age is not used as a predictive variable, lenders may look to the Regulation B criteria as useful fair lending benchmarks when developing and evaluating a credit scoring system.

A benefit of credit scoring systems, if properly constructed, is the objectivity they instill in the credit evaluation process. Well-constructed systems apply the same criteria to all credit applicants, without consideration of prohibited bases, such as gender or race and, to a limited extent, age. Credit scoring systems may help lenders facilitate consistency and limit discretion in the credit evaluation process, and thus, promote fair lending.[3]

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[3] Generally, federal fair lending laws recognize two types of lending discrimination: disparate treatment and disparate impact. Disparate treatment occurs when there is overt discrimination or when a lender treats similarly situated applicants differently based on one of the prohibited factors under ECOA or the Fair Housing Act, even if unintentionally. Disparate impact can occur when a facially neutral policy applies equally to all applicants, but adversely affects protected groups.

## II. Fair Lending Enforcement under ECOA

As a supervisor of financial institutions, the Board has a long-standing commitment to ensuring that every bank it supervises complies fully with the federal fair lending laws (ECOA and the Fair Housing Act). Fair lending is an integral part of every consumer compliance examination. Following the Interagency Fair Lending Examination Procedures, each fair lending examination includes an assessment of the bank's fair lending risk across its business lines, such as mortgage, consumer, and auto lending. Based on this risk assessment, examiners identify the specific business lines on which to focus, and in each examination evaluate in detail at least one product or class of products. As part of this process, examiners may evaluate an institution's credit scoring system, as well as how credit scores are used in the credit evaluation process.

When evaluating an institution's proprietary credit scoring system, examiners review all of the factors considered within the system. First, examiners ensure that prohibited bases, with the exception of age, are not used. If a credit scoring system considers age, examiners ensure that it meets the appropriate standards pursuant to Regulation B. Second, examiners consider whether any factors in the system may serve as proxies for a prohibited basis or may have a disparate impact on a prohibited basis. If examiners have questions about the appropriateness of a factor, they engage in further review to assess its legitimacy. This additional review may include an evaluation of the factor's predictiveness and whether other factors might be used instead.

The Board also supervises many institutions that do not develop and use their proprietary credit scoring systems, but rely on third-party credit scoring systems. When performing underwriting and pricing examinations, examiners evaluate how institutions use credit scores and credit scoring systems. Examiners focus on whether the credit scores, as well as other

underwriting and pricing factors, are applied consistently to all applicants. Particular attention is paid to any exceptions to credit score thresholds and whether those exceptions are applied consistently. Within the past five years, the Board has not found any fair lending violations based on a lender's proprietary credit scoring system or a lender's use of third-party credit scoring system.

Fair lending violations have been found on other bases, however. When examiners find fair lending violations, the Board does not hesitate to take action. If there is reason to believe that an institution has engaged in a pattern or practice of discrimination under ECOA, the Board, like the other federal banking agencies, has a statutory responsibility under that Act to refer the matter to the Department of Justice (DOJ).[4] The Board takes this responsibility seriously.

For example, in 2007, the Board referred eight institutions to DOJ after concluding that there was reason to believe that the institutions had engaged in a pattern or practice of discrimination. One referral involved racial discrimination in the pricing of automobile loans. Four referrals involved discrimination on the basis of marital status. Another referral involved an institution with two loan policies found to be discriminatory. One policy prohibited lending on Native American lands and the other restricted lending on row houses, which resulted in discrimination against African-Americans. The last two referrals involved ethnic and racial discrimination in mortgage pricing by nationwide lenders.

## III. Credit Scoring and Its Effects on the Availability and Affordability of Credit

As a research institution, the Board conducts and publishes analyses of significant trends in the credit markets. In recent decades, consumer credit markets have become national in scope,

[4] After receiving an agency referral, DOJ reviews the matter and decides if further investigation is warranted. A DOJ investigation may result in a public civil enforcement action or settlement. DOJ may decide instead to return the matter to the Board for administrative enforcement. If a matter is returned to the Board for administrative enforcement, or if the violation does not constitute a pattern or practice, the Board acts to ensure the institution corrects the problems and makes amends to the victims.

with credit being made available to a broader spectrum of consumers. The development and use of credit scores has greatly facilitated these trends. As noted earlier, credit scoring is a statistical methodology that quantifies the credit risk posed by a prospective or current borrower. Credit scores seek to rank-order individuals by their credit risk; those with poorer scores are predicted to perform on average worse on their credit obligations than those with better scores.

Credit scoring is widely used to evaluate applications for credit, identify prospective borrowers, and manage existing credit accounts. It is also used to facilitate decision-making in other areas including insurance, housing, and employment. The large savings in cost and time that have accompanied the use of credit scoring are believed to have increased access to credit, promoted competition, and improved market efficiency.

As directed by Congress in the FACT Act, the Board in August 2007 prepared a report on a number of matters regarding credit scoring, including how it has affected the availability and affordability of credit, the relationship between credit scores and other factors, and whether the use of credit scoring systems has fair lending implications under ECOA.

*A. Background on the Report*

Little research has been conducted on the potential effects of credit scoring on minorities or other demographic groups, largely because of a lack of data linking credit scores to race, ethnicity, and other pertinent demographic information about individuals. With the exception of dates of birth, the credit records maintained by the consumer-reporting agencies,[5] which serve as the basis for most credit-scoring systems, do not include any personal demographic information.

In addition to reviewing public comments, previous research, studies and surveys, Board staff conducted unique research specifically to develop information needed to prepare this report. Board staff created a database that, for the first time, combines information on personal

[5] The three national consumer-reporting agencies are Equifax, Inc., Experian, and TransUnion LLC.

demographics collected by the Social Security Administration (SSA) with a large, nationally representative sample of the credit records of individuals. The sample comprised the full credit records of more than 300,000 anonymous individuals drawn in June 2003 and updated in December 2004 by TransUnion LLC (TransUnion).[6] Because the data set consisted of the credit records of the same individuals for both of these dates, Board staff was able to construct measures of loan performance, credit availability, and credit affordability and was able to create its own credit-scoring model (the FRB base model) and credit scores (FRB scores).[7]

The data supplied by TransUnion for each individual in the sample also included two commercially generated credit scores--the TransRisk Account Management Score (from TransUnion) and the VantageScore (from VantageScore Solutions LLC).[8] The design of the FRB base model followed general industry practice to the extent possible.[9] The three credit scores, together with the unique combination of credit and demographic information in the data set created for this purpose, allowed the Board to address the questions posed by the Congress.

*B. Findings of the Report*

The report's findings focus on: (1) the effects of credit scoring on access to credit; (2) differences in credit scores, loan performance and credit availability and affordability across different populations; and (3) the extent to which individual credit characteristics included in credit scoring systems may have a negative or differential effect on specific demographic populations.

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[6] Personal identifying information of the individuals in the sample, such as names and Social Security numbers, was not made available to the Board.

[7] For the study, Board staff developed five distinct measures of performance that relate to payments on new or existing accounts and to collection actions and derogatory public records. The study focused on credit history scores, that is, scores calculated exclusively on the basis of individuals' credit records as assembled by the three national consumer-reporting agencies. Other kinds of credit scores were not studied here.

[8] TransRisk Account Management Score is a registered trademark of TransUnion LLC, and VantageScore is a service mark of VantageScore Solutions LLC.

[9] The details of the estimation process and the credit characteristics and their associated weights are provided in the report.

1. Access to Credit

The evidence from public comments received for this study, from review of previous research, and from an assessment of data from the Board's Survey of Consumer Finances indicate that credit scoring has increased the availability and affordability of credit. Credit scoring allows creditors to quickly and inexpensively evaluate credit risk and to more readily solicit the business of their competitors' customers regardless of location. Credit scoring increases the consistency and objectivity of credit evaluation and thus, has reduced some of the discretion that could lead to discrimination against certain segments of the population.

Credit scoring also increases the efficiency of consumer credit markets by helping creditors establish prices that are more consistent with the risks and costs inherent in extending credit. By providing a low-cost, accurate, and standardized metric of credit risk for a pool of loans, credit scoring has broadened creditors' access to capital markets.

2. Credit Scores and Loan Performance, Availability, and Affordability Across Populations

The data assembled for the study were used to investigate the variation in credit scores across populations, and the relationship between credit scores and subsequent loan performance, availability, and affordability across populations.

*(a) Credit Score Variation*

Credit scores differ among subpopulations: Blacks, Hispanics, single individuals, those younger than age 30, and individuals residing in low-income or predominately minority census tracts have lower credit scores on average than other subpopulations defined by race or ethnicity, age, or location. Because individuals with identical items in their credit records receive the same credit score, population differences in scores must stem from average differences in their credit record information, such as differences in the incidence of serious delinquencies. Groups with

lower average scores tend to have had a higher incidence of payment problems on credit obligations, collection actions, and public record items such as garnishment and bankruptcy. Other factors, such as utilization of available credit and the length of credit history, also affect credit scores. The study found that differences across groups in average credit scores are narrowed, but not always eliminated, when differences in other personal demographic characteristics, such as marital status, residential location, or a census-tract-based estimate of an individual's income, are taken into account.

*(b) Loan Performance*

The study analyzed whether loan performance, as measured by several different metrics of serious delinquency, differed across population groups controlling credit scores. For every performance measure evaluated and for every population group considered, the study found that credit scores consistently rank-order the credit risk of individuals. Regardless of credit score range, the higher (better) the credit score, the lower the observed incidence of future default. This finding was true for the population as a whole and within all major demographic groups. Thus, when other personal demographic characteristics, as well as marital status, residential location, or a census-tract-based estimate of an individual's income, are controlled, credit scores consistently predict relative loan performance across all population groups.

*(c) Credit Availability and Affordability*

The study also analyzed the extent to which credit scoring affects the availability and affordability of credit by geography, income, race, color, national origin, age, sex, or marital status. The study found that credit scores consistently relate to measures of "inferred" loan

denial and loan pricing.[10] For all populations, interest rates and average inferred denial rates consistently decline as credit scores increase. Similar to the findings for loan performance, some differences were observed across population groups after controlling for credit score. Most notably, younger individuals appear to experience somewhat higher inferred denial rates than older individuals; blacks appear to incur somewhat higher interest rates on automobile and installment loans than do non-Hispanic whites; and Asians incur interest rates that, on average, are typically lower than, or about equal to, those paid by non-Hispanic whites across all loan categories for which interest rates could be estimated. Data limitations prevent a full assessment of the reasons for the remaining differences in credit outcomes. Most importantly, credit records do not include information on many of the factors lenders consider in underwriting and pricing credit, including income and assets, down payments, employment experiences, or wealth.

*(d) Individual Credit Characteristics and Their Effects Across Populations*

The study reviewed the extent to which the consideration of certain factors, or lack thereof, by credit scoring systems could result in a negative or positive differential effect for different populations. By law, credit scoring systems must exclude from consideration an individual's personal characteristics, such as race or ethnicity, national origin, sex, and, to a limited extent, age. A concern exists that, despite this prohibition, a credit characteristic may be included in a credit scoring system as a substitute, or proxy, for a prohibited demographic characteristic, such as race, ethnicity, or sex.

Analysis of the data used for the study found that few credit characteristics (for example, number of credit inquiries, utilization rate, and months since recent delinquency) that would be included in credit scoring systems, and which were used in the FRB base model, correlated with

[10] In this report, Board staff used the data on credit inquiries to infer whether an individual likely experienced a credit denial. For example, an inquiry on an individual's credit record without any record of a subsequent extension of credit to the applicant was treated as a denial of credit.

personal demographics, such as race, ethnicity, sex, and age. Therefore, the study found that such credit characteristics are unlikely to serve as proxies for demographic characteristics. A primary exception to this finding is that some credit characteristics correlate highly with an individual's age.

To determine whether the credit characteristics in the FRB base model served, at least in part, as proxies for race or ethnicity, sex, or age, the FRB base model was re-estimated in race-neutral, age-neutral, and sex-neutral environments. To accomplish this, the models were estimated with samples limited to a single population for each model. In those models, any credit characteristics serving solely as a proxy for race, ethnicity, age, or sex should have little weight in the re-estimated model. Credit characteristics that have both an independent effect on performance and a correlation with race, ethnicity, age or sex would be expected to have significantly different weights (either larger or smaller) in the re-estimated models.

Re-estimating the FRB base model in a race-neutral or sex-neutral environment had virtually no effect on average group credit scores. This finding suggests that the credit characteristics included in the FRB base model to predict loan performance do not serve, to any substantive degree, as proxies for race, ethnicity, or sex. However, when the model is re-estimated in an age-neutral environment, credit scores did change slightly. The study traced this result to the inclusion of a specific credit characteristic--the length of an individual's credit history. Further analysis showed that this credit characteristic served, in part, as a proxy for age. However, the length of credit history showed significant predictive power in an age-neutral environment. As a result, excluding the length of credit history would reduce the overall predictiveness of the model, lowering the scores of older individuals and raising the scores of younger individuals.

Evidence also shows that recent immigrants have slightly lower credit scores than would be implied by their loan performance. Credit history profiles of recent immigrants resemble those of younger individuals, whose credit performance tends to be poor relative to the rest of the population. To address this concern, however, the length of credit history would have to be excluded from the model, which would create other problems including loss of model predictiveness. An alternative approach to address this concern would be to expand the information supplied to credit reporting agencies to gain a broader picture of the credit experiences of recent immigrants and other individuals. Such information could include rent, utility, and other recurring bill payments.

**Conclusion**

The Board is committed to addressing racial and ethnic gaps in the availability and affordability of credit. In its multi-faceted role as a rule writer, bank supervisor, and research institution, the Board is able to take a comprehensive approach towards identifying and addressing potential fair lending concerns within the credit evaluation process, including credit scoring. The Board reviews and updates Regulation B to ensure its rules continue to effectively prohibit consideration of any prohibited basis under ECOA throughout the lending process. Second, the Board supervises financial institutions to ensure their compliance with ECOA and other fair lending laws, and takes enforcement action when necessary. Third, the Board studies significant trends in the credit market, and uses data from these studies to inform and facilitate the Board's ongoing rule writing and enforcement efforts.

**For Immediate Release:**
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Thursday, July 10, 2008
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# CONSUMER UNDERSTANDING OF CREDIT SCORES IMPROVES BUT REMAINS POOR

***Consumers Could Save $28 Billion a Year in Lower Credit Card Finance Charges***
***If They Improved Credit Scores by 30 Points***

Washington, DC-- Although consumer understanding of credit scores has improved over the past year, it remains poor, according to the latest credit score survey commissioned by the Consumer Federation of America (CFA) and Washington Mutual Bank (WaMu). Less than one-third of Americans (31%), for example, understand that credit scores indicate risk of not repaying a loan, rather than factors like knowledge of, or attitude toward, consumer credit.

"Lack of consumer knowledge about credit scores not only increases the costs of their credit and insurance, but also reduces the availability of these and other services," said CFA Executive Director Stephen Brobeck.

However, learning about these scores and applying the knowledge can significantly raise them. "By taking a few simple steps, American consumers have the power to reduce their collective credit costs by billions of dollars annually," said Anthony Vuoto, president, Washington Mutual Card Services.

For this report, WaMu -- using data supplied by Argus Information and Advisory Services -- estimated that U. S. consumers could reduce card finance charges by $105 annually if they raised their score by 30 points. If all consumers raised their scores by 30 points, total annual consumer savings would be an estimated $28 billion.

Consumers can raise their credit scores in many ways, especially by:

- Consistently paying their bills on time every month.

- Not maxing out, or even coming close to maxing out, their credit cards or other revolving credit accounts.

- Paying off debt rather than just moving it around, as well as not opening many new accounts rapidly.

- Regularly checking their credit reports, which can be obtained for free, to make sure they are error-free. Federal law requires the three main credit bureaus -- Experian, Equifax, and TransUnion -- to make available to consumers, upon request and at no charge, one credit report per year at www.annualcreditreport.com.

In August 2005, May 2007, and June 2008, Opinion Research Corporation (ORC) conducted extensive surveys of consumer knowledge of credit scores for CFA and WaMu. In all three years, ORC surveyed more than 1,000 representative adult Americans. The margin of error in these surveys is plus or minus three percentage points.

**Consumer Understanding of Credit Scores Improves**

Comparing responses in the 2005 and 2007 surveys found little improvement in consumer understanding of credit scores. But, comparing responses in the 2007 and 2008 surveys revealed that an increasing percentage of Americans understand several important facts about credit scores.

- Twenty-eight percent, up from 24% in 2007, knew that 700 was the approximate lowest credit score that would qualify one for a low-rate mortgage; and 26%, compared to 19% in 2007, selected 400 or 500 as the score (incorrect) qualifying for a low-rate mortgage.

- Credit scores would rise if one paid off a large credit card balance -- up from 62% to 67% -- and would fall if one made a monthly credit card payment more than 30 days late -- up from 71% to 78%.

- The fact that insurers often use credit scores -- up from 58% to 64%, -- and that landlords often use these scores -- up from 55% to 59% -- in deciding whether one can buy a service or rent housing and at what price.

- From a list including Experian, Equifax, and TransUnion, the percentage of respondents recognizing that Tenneco is not a credit bureau -- up from 47% to 54%.

**But This Understanding Remains Poor**

Few consumers understand what a credit score actually represents. Only 31% correctly identified the answer "risk of not repaying the loan" in a multiple choice question that also included "financial resources to pay back loans" (21%), "amount of consumer debt" (16%), "knowledge of consumer credit" (15%), and "attitude toward consumer credit" (9%) as other options. And, as noted above, less than one-third (28%) knew the lowest score (700) that might qualify for a low-rate mortgage.

Many Americans fail to understand that one's credit score reflects only how they use credit, not factors such as income and age. Significant percentages erroneously believe that credit scores are influenced by income (74%), age (40%), marital status (38%), the state in which they live (29%), level of education (29%), and ethnicity (15%).

While more than three-quarters (78%) correctly understand that making a monthly payment more than 30 days late lowers one's score, less than three-fifths (59%) know that maxing out a credit card by using the entire credit line also lowers scores.

Large majorities correctly understand that they can learn their credit scores if they are denied a mortgage loan (72%) or declined for a credit card (65%). But, an even larger majority, (79%), incorrectly believes that credit scores can be obtained for free once a year. (Only credit reports can be obtained annually for free.)

**Those Who Have Obtained Their Scores Are Most Knowledgeable**

The improvement in consumer knowledge of some credit score issues may largely reflect the fact that more Americans have obtained their credit score in the past two years -- up in 2008 to 49% from 42% the year before. Those who obtain their scores know more about credit scores than those who have not. They are more likely to know, for example, that:

- Credit scores indicate the risk of nonpayment (34% vs. 27%);
- Tenneco is not a credit bureau (65% vs. 35%);

- 700 is the lowest score (approximately) that may qualify for a low-rate mortgage (35% vs. 16%);

- Maxing out a credit card lowers one's score (65% vs. 51%), but paying off a large credit card balance raises one's score (71% vs. 62%), and;

- The fact that many service providers use credit scores -- not just mortgage lenders (94% vs. 80%) and credit card issuers (89% vs. 76%), but also cell-phone companies (63% vs. 55%) and landlords (62% vs. 54%).

However, the gap between obtainers and non-obtainers, in terms of those who consider their knowledge of credit scores to be excellent or good, is far larger -- 67% vs. 26% -- than specific knowledge gaps. This is worrisome because knowledge levels for both are low, and those who think they know something, but don't, may make poorer decisions that those who know they don't know something.

**The Most Important Information Consumers Should Know About Credit Scores**

CFA and WaMu believe that all consumers should know important facts about credit scores:

- Scores reflect only one's past credit history, not personal characteristics, such as age, gender, or level of income. Over time, consumers have the ability to raise their scores.

- Low scores could not only cost individual consumers thousands of dollars a year in additional finance charges, but can also deny access to credit, insurance, telephone service, a rental unit, and even a job.

- Consumers with credit scores below 600 are almost always charged relatively high "subprime" loan rates, while those with scores above 700 are often charged relatively low "prime" rates, while those with scores above 760 are generally charged the lowest rates.

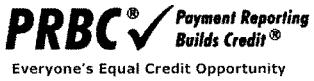
While consumers are entitled to one free credit report each year from each of the credit bureaus, those who want to more carefully or regularly monitor their credit score must pay a fee (starting at $15). Contact Fair Isaac (www.myFICO.com), or the three bureaus -- TransUnion (www.transunion.com), Experian (www.experian.com) or Equifax (www.equifax.com) .WaMu credit card and home equity line of credit customers can receive a TransUnion-derived credit score monthly for free online.

**About Consumer Federation of America**

CFA is an association of some 300 non-profit consumer groups that seeks to advance the consumer interest through research, education, and advocacy.

**About Washington Mutual**

WaMu, through its subsidiaries, is one of the nation's leading consumer and small business banks. At March 31, 2008, WaMu and its subsidiaries had assets of $319.67 billion. The company has a history dating back to 1889 and its subsidiary banks currently operate approximately 2,500 consumer and small business banking stores throughout the nation.




July 29, 2008

Congressman Melvin L. Watt
Chairman, The Financial Services Subcommittee on Oversight and Investigations
U. S. House of Representatives Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

RE: What Borrowers Need to Know About Credit Scoring Models and Credit Scores

Dear Congressman Watt:

Pay Rent, Build Credit, Inc., dba *PRBC*® and dba *Payment Reporting Builds Credit*®, appreciates the opportunity to submit comments to The Financial Services Subcommittee on Oversight and Investigations in connection with its timely hearing today, "What Borrowers Need to Know About Credit Scoring Models and Credit Scores", and about non-reported bill payments in particular, also known as "alternative credit".

PRBC commends the Members of Congress and The House Financial Services Committee on their efforts to inform the public about credit reports and scores, and the processes that cover credit information and its use under the Fair Credit Reporting Act (FCRA), the Fair and Accurate Credit Transactions Act (FACTA), and the Equal Credit Opportunity Act (ECOA).

PRBC offers brief comments today covering three (3) topics to provide information on non-reported bill payments that when better understood, could help the estimated 50 million consumers with little or no traditional credit histories or scores such as young adults, divorcees, new immigrants, minorities and the elderly to avoid high interest rate auto and mortgage loans and to increase their chances of building asset-based wealth and financial security. These comments are also intended to illustrate an innovative, responsive, and potentially profitable new way for financial institutions to assist their depositors, check cashing and bill payment customers to build a more complete and accurate credit report and score that the institution can use to make proactive loan offers on fair and appropriate terms, while assuring the safety and soundness of their institutions.

The three topics discussed herein are:

1. It is a myth that it is possible to build a good credit history and score simply by paying all of your monthly bills on time.

2. The FHA and GSEs make a distinction between "bill payments" and other forms of "non-traditional" or "alternative" credit information.

3. The "Credit Rating in Your Shoe Box" and ECOA Regulation B, Section 202.6

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*About PRBC*

Founded in March 2002, and with early R&D funding from The Ford Foundation, Fannie Mae, Freddie Mac, Citimortgage and IBM, PRBC is today a venture capital-funded consumer reporting agency, commonly known as a credit bureau. PRBC was launched to include commonly recurring but non-reported monthly bill payments in credit reports and scores, and to support automated underwriting, as well as fair and accurate risk based pricing.

PRBC aggregates, stores, scores, and reports payments for common credit-like obligations that most adult individuals, family households, and small business owners make each month for housing, auto loans, commercial leases, utilities, phone service, cable, and insurance.

PRBC accepts monthly bill payment data from three sources, the first two of which are unique for a credit bureau:

1. Reported from a financial institution's bill payment service on behalf of its customers

2. Self-reported by a consumer, subject to a rigorous third-party verification that meets and exceeds FHA's and the GSEs' standards

3. Directly from billers, lenders, and landlords in the traditional credit reporting mode

PRBC enables consumers and small business owners to build their own PRBC bill payment history that can be scored, using a secure Internet connection based on their past three (3) years of payments. It only takes 24 - 48 hours to build a file and obtain a third-party verification.

A PRBC Report℠ with a Bill Payment Score® (BPS®) or FICO® Expansion® Score can be accessed electronically directly from PRBC or from an authorized reseller with a consumer's permission under the FCRA, similar to a report and score from Equifax, Experian, and TransUnion, whenever a credit report and score are used to assess their creditworthiness.

PRBC Reports℠ with BPS® or FICO® Expansion® Score are designed to be used as a supplement to a traditional credit report and score if any exists, or if an applicant has no traditional report and score, to provide a more complete and accurate picture of an applicant's creditworthiness.

PRBC does not charge consumers to view their own file , nor does it sell their identifying information or bill payment histories for pre-screened offers without their express consent.

For more information about PRBC Reports℠ with BPS ® or FICO® Expansion® Score, see Attachment A.

***Myth – pay your bills on time to build a good credit history and score***

The common wisdom is that consumers can build a good credit history and score by paying all of their monthly bills on time. The FDIC's *Money Smart*, and most other financial literacy materials advocate this responsible practice. Paradoxically and unfortunately, it is not true for many of the common bills that consumers pay on-time each month. The truth is that to build a credit history and score, consumers must go into debt and borrow money from a lender that reports to a credit bureau, and not all lenders report. The reason is that credit reporting in the United States is "voluntary". That is, service providers or "billers" such as landlords, utilities, telcos, and insurance companies, as well as lenders may report to a credit bureau, but they are not required to do so. Further, many smaller lenders, billers, and landlords can not report to a bureau even if they want to because they do not have the minimum number of accounts required and it is not economically feasible for a bureau to credential them under the FCRA, or to accept their data with the necessary quality controls.

*Credit scores only reflect what is reported to a bureau. If credit reports are missing payment accounts or "trade lines" because they are not reported, or if there are errors in the report, no credit score or scoring model will produce a complete or accurate picture of the applicant's creditworthiness.*

Missing positive payment information has an unintentional but distinctly unfair and negative impact on two groups of consumers when they apply for housing (rent or mortgage), auto loans, short term loans, insurance, utility hook-ups, telecom service, and employment.

> The first group is large, estimated at 50 million individuals, and includes those who pay their regular bills such as rent, utilities, phone, and insurance on time, but who have chosen not to use traditional forms of credit. While this category of consumers are often fiscally responsible and otherwise good credit risks, they have little or no payment histories in Equifax, Experian, or TransUnion, or traditional credit scores. *Ironically, having no positive or negative credit history in one or more of these three credit bureaus has the same effect as having bad credit when a traditional report and score are used to assess an applicant.*
>
> The second group of consumers who are negatively impacted by missing positive payment information are among the 60 million individuals who have had late payments and/or have defaulted on credit obligations in the past. Many of these consumers are trying to rehabilitate their financial situation and behavior, and have paid their bills on time since then. While many in this group defaulted on their credit obligations because of moral hazard (i.e. they misused credit to live beyond their means), others' past credit problems may have resulted from predatory lending practices or circumstances beyond their control such as illness, loss of employment, or divorce.. When their credit accounts are closed, their "traditional" credit reports and scores become frozen in time and become outdated. A consumers' inability to show that they have paid their bills on time since their last reported late payments or charge-offs, prevents them from recovering financially from prior events either beyond their control or due to past financial management mistakes.

The unintended impact of missing positive monthly bill payment data on these two groups of consumers is that: i) consumers who make their monthly bill payments on time do not have a complete and accurate record of payment that can be accessed electronically or scored, ii) their creditworthiness is difficult to accurately assess by housing providers, lenders, insurance, utility and telecom providers, as well as by employers, iii) they often are required to post high security deposits for utility hook-ups and phone service, and iv) because they often have lower credit scores than they should, they often pay more for housing, credit, and insurance than they deserve, making it difficult for them to build assets and to secure their financial futures.

The problem of missing positive payment information also makes it difficult for authorized users of credit reports to accurately assess applicants, price loans and insurance offers, to compete for new business, and to efficiently securitize loans in the secondary markets made to borrowers with low- and no- FICO scores.

***FHA defines monthly "bill payment" information. It is not "non-traditional" or "alternative". Everyone pays bills.***

The FHA, Fannie Mae, and Freddie Mac have long-accepted evidence of an on-time bill payment history for borrowers with no traditional credit report or score. On April 29, 2008, the FHA reiterated this policy in Mortgagee Letter 2008-11 and listed those bill payments that are acceptable. They include:

- rental housing payments (subject to independent verification if the borrower is a renter)
- utility company reference (if not included in the rental housing payment), including gas, electricity, water, land-line home telephone service, cable TV
- insurance coverage, i.e., medical, auto, life, renter's insurance (not payroll deducted)
- payment to child care providers – made to a business providing such services;
- school tuition
- retail stores – department, furniture, appliance stores, specialty stores; rent to own – i.e., furniture, appliances;
- payment of that part of medical bills not covered by insurance
- Internet/cell phone services
- a documented 12 month history of saving by regular deposits (at least quarterly/non-payroll deducted/no NSF checks reflected), resulting in an increasing account balance
- automobile leases, or a personal loan from an individual with repayment terms in writing and supported by cancelled checks to document the payments.

These commonly recurring bill payments are not "non-traditional" or "alternative". They are clearly defined by the FHA, and many consumers pay them on-time each month.

Recognizing that use of this bill payment information in the past has resulted in loan performance that varied widely from lender to lender, and that paper-based evidence of an applicant's bill payment history can not be scored or used outside of mortgage lending, the FHA Mortgagee Letter 2008-11 stated the FHA's requirement that "bill payment histories" be:

1. "Independently verified" by a third-party with no financial connection to a lender
2. Reported by a "credit bureau", opening the door to the use of scores.

***The "Credit Rating in Your Shoe Box" and the Equal Credit Opportunity Act – an economic opportunity and responsibility for lenders and consumers.***

Business Week Magazine reported in its April 21, 2008 edition about *The Credit Rating in Your Shoe Box,* featuring the PRBC service of converting a consumer's paper-based proof of past bill payments into a credit report and score that can accessed electronically.

Consumers have a legal right and personal responsibility under ECOA[1] Reg B, Section 202.6 to have their non-reported monthly bill payments considered to qualify for the lowest rates and best terms they deserve when a lender assesses their "creditworthiness". To comply with ECOA Reg B, lenders may sift through an applicant's "shoe box" full of paper, verify it and score it somehow, or pull a PRBC Report℠ with BPS® or FICO® Expansion® Score, electronically – in seconds.

The problem is that consumers do not know they have this valuable right, nor do they know how to take advantage of it. Policy makers and financial service institutions could play an important role in creating public awareness, and financial service institutions have a strong economic incentive to do so.

The PRBC bill payment reporting service is designed to be offered by financial service institutions under their own "brand identity", to attract new depositors and customers interested in building credit with the institution's bill payment service. The PRBC service provides lenders and service providers with a unique opportunity to adopt the responsible policy and practice of advising their applicants to proactively demonstrate their creditworthiness ***before*** they apply for credit, ***or if they are rejected or do not receive the most favorable rate and terms***, so that valuable and predictive bill payment data that is often missing from traditional reports and scores can be counted in the applicant's favor.

As a bonus, financial institutions regulated by the Federal reserve, FDIC, OCC, OTS, and State of NY Banking Department may receive CRA credit[2] for providing a "community development service" for doing so.

Sincerely,

Michael G. Nathans
Founder & Chairman
Pay Rent, Build Credit, Inc.

**NOTES**

[1] ECOA Subsection 202.6 (b) (6) Rules concerning evaluation of applications.

(b) *Specific rules concerning use of information.*

(6) *Credit history.* To the extent that a creditor considers credit history in evaluating the creditworthiness of similarly qualified applicants for a similar type and amount of credit, in evaluating an applicant's creditworthiness a creditor shall consider:

(i) The credit history, when available, of accounts designated as accounts that the applicant and the applicant's spouse are permitted to use or for which both are contractually liable;

(ii) On the applicant's request, any information the applicant may present that tends to indicate that the credit history being considered by the creditor does not accurately reflect the applicant's creditworthiness; and

(iii) On the applicant's request, the credit history, when available, of any account reported in the name of the applicant's spouse or former spouse that the applicant can demonstrate accurately reflects the applicant's creditworthiness.

[2] The founders of PRBC received an opinion letter from the Federal Reserve Board of Governors, Division of Consumer and Community Affairs in March 1997, and a similar letter from the State of New York Banking Department in May 2003 stating that it is an innovative and responsive "community development service" under the Community Reinvestment Act when an institution uses it information reporting technology to assist its low- and moderate-income customers to build a credit history with their rental and other bill payments by reporting to a credit bureau such as PRBC.

http://www.prbc.com/pub/Federal_Reserve_Board_CRA_letter.pdf

http://www.prbc.com/pub/NY_State_Banking_Dept_Letter.pdf

**Attachment A**

## A. *PRBC Report℠ with FICO® Expansion® Score*

**Credit Scoring - Finding the Prime in Subprime**

*By Shawn Moore, Product Management Director, FICO Global Scoring Solutions.*

Even during times of lean credit availability, there is still a need to serve thin-file consumers and identify the good risks.

The problem the mortgage industry faces in reaching out to these consumers is separating the good risks from those who are truly high risk. Because they were unscorable, without a time-consuming manual validation they all look alike. As exceptions, they get thrown into the subprime processes regardless of whether or not they might really be "prime" worthy.

And, as lenders discovered in the subprime meltdown, too many self-documented, thin-file loans turned out to be fraught with fraud. Some consumers used inflated or misleading information on applications, and that information might have been validated by parties with vested interests—for example, brokers who were trying to push a loan through.

But the other side of the story is that many individuals who fell into the thin-file bucket—including many who were likely turned down even for subprime loans—were potentially creditworthy.

**Finding the creditworthy among thin-file, no-file borrowers**

Fair Isaac recently announced a collaboration with Payment Reporting Builds Credit (PRBC), a credit information repository that (with a consumer's approval) collects, verifies and scores rental and bill payment data. PRBC's service is designed to enable lenders to better evaluate applicants who have little or no recent credit history.

The collaboration combines PRBC's verified data with FICO® Expansion® score data and analytics to deliver a more complete and accurate assessment of applicant risk—one that meets Fannie Mae, Freddie Mac and HUD requirements.

The collaboration will solve several problems for lenders. Lenders now can:

• **Qualify creditworthy customers among the large no-hit/thin-file group.** Thin-file consumers make up a large population—an estimated 35-50 million adults in the US—almost 25% of the adult population and 5% to 8% of the mortgage market. They fall into several categories: young borrowers who haven't had time to establish a credit history, new immigrants, and many older people with assets but who did not ever become part of the "credit card generation." Among this huge population, lenders can identify applicants who represent more clearly defined risks (prime, near-prime, subprime) and offer them more accurately priced products and potentially more attractive rates than they could otherwise.

• **Reduce verification time and focus resources.** Lenders who want to serve this population face a daunting need for documentation and verification of applicant-supplied information. Applicants that do not have enough trade lines to create a score have to prove they have paid rent and utilities. Lenders faced a choice of spending days of elapsed time and many hours of their underwriting staff time tracking down landlords and billers, or relying on verifications provided by brokers or loan officers who in many cases have conflicts of interest when acting as verifiers. PRBC Verifications reduce that time to approximately 24-48 hours. And with the addition of a score, lenders can segment applicants by risk, price accordingly, and see where they should further concentrate their underwriters' efforts.

• **Obtain a robust score for thin and no-file applicants.** The combination of PRBC data and a FICO® Expansion® score provides a solution that is more than the sum of its parts. The addition of properly verified trade line information from the PRBC repository to the FICO® Expansion® score gives new power to the score. And because the FICO® Expansion® score combines additional data sources (e.g., traditional credit repositories, utilities, membership club, public records, demand deposit, third-party non-traditional data) with PRBC bill payment data, it can uncover signs of risk that would otherwise go unnoticed—for example, a history of NSF checks or non-payment of rent. The result of this wide range of validated data is a balanced, robust risk management score with the same range and scaling as traditional FICO® scores.

Scores, reason statements and trade lines are delivered in the report. Lenders using it are compliant with FCRA, GLBA, ECOA and FACT Act regulations, while earning CRA credit.

Lenders now want to renew their focus on risk management. They also want safe ways to reach out to new, rapidly growing but traditionally credit-underserved populations. This partnership gives them the tools to fulfill both those objectives.

*Lenders can easily access this new package through their existing connections to NCRA member credit reporting agencies.*

## B. *PRBC Bill Payment Score®*

The PRBC Bill Payment Score (BPS®) reflects a consumer's or small business owner's willingness and ability to pay on time consecutively, and takes into account many bill payment history factors to generate a score between 350 and 800. Consumers, small business owners, and automated underwriting systems alike can understand the simplicity and predictive power of the PRBC Report and BPS.

PRBC scores individual trade lines based on the length of history for the trade line type and the timeliness of payments made. The timeliness score is affected by slow and late payments, the number and severity of late payment(s), the account type, and the number of months since the most recent late payment. A late payment three months ago will impact the score more than a late payment five months ago.

The overall BPS is based on the number of trade lines scored and the weighted scores for those trade lines. Trade line scores are weighted to give certain trade line types greater impact on the score than others. For example, mortgage and rent payments are weighted higher than electric bill payments which are weighted higher than furniture lease payments. In addition to the common credit obligations of most households such as rent and utilities payments, PRBC also collects and reports both positive and negative payday loan repayment data. On the advice of its consumer advocate advisors, PRBC does not score payday loan payments. PRBC displays payday loan repayment data in a separate section of PRBC Reports that illustrates a consumer's willingness and ability to repay these short-term obligations as agreed, or not, potentially enabling them to migrate to more affordable credit alternatives.

For illustration, a consumer who has made 12 consecutive on-time residential rent payments plus three utility trade line payments (i.e. electric, cable, and phone) would have a PRBC BPS 616. A PRBC BPS of 616 comprised of 12 months of consecutive on time payments for rent plus three other tradelines meets the FHA, Fannie Mae, and Freddie Mac underwriting guidelines for using non-traditional credit data to qualify an applicant with no

credit file or score from any of the "big 3" for a mortgage loan. A consumer who has made these same payments for 24 months would have a BPS 689.

It is simple for a consumer or business owner to build their PRBC file and raise their PRBC BPS by paying more bills on time consecutively.

**PRBC BPS Key Factors and Score Weighting:**

- Length of Payment History - 20%
- Timeliness of Payments - 25%
- Severity of Late Payments - 10%
- Time since last Late Payment - 15%
- Number of Trade Lines - 10%
- Types of Trade Lines - 20%

To assure data security, quality, reliability, and to mitigate cost, PRBC accepts billing and payment data uploads directly from bill payment service providers, billers, and lenders using an XML format and a Secure Socket Layer Internet connection with 128 bit encryption.

PRBC assures the reliability and quality of historical data that is provided directly from consumers, by utilizing trained FCRA-certified specialists to verify SSN, ITIN, EIN, current address, historical lease, mortgage, utility, phone, cable, and other recurring bill payments, along with judgments and collection accounts. PRBC's procedures for historical verifications meet and exceed industry and regulatory standards.

**Submission of Additional Information Relating to the Oversight and Investigations Subcommittee Hearing Entitled: "What Borrowers Need to Know About Credit Scoring Models and Credit Scoring," July 29, 2008**

During the second panel, Chairman Watt posed a question to Clark Abrahams suggesting that the proposed comprehensive credit framework might increase the subjectivity of the credit granting process. Chairman Watt asked to be "convinced that he is wrong". The purpose of this submission is to provide additional information as to how the Comprehensive Credit Assessment Framework decreases the amount of subjectivity in the credit process.

Thank you Mr. Chairman for this opportunity to provide additional information about how the Comprehensive Credit Assessment Framework (C-CAF) actually diminishes subjectivity in the credit granting process.

Let's start by taking Congressman Cleaver's grandmother as an example. As the Congressman explained during his opening statement, his grandmother paid everything in cash and on time. She had no history with credit. Because she lacked a credit history, she would not, under current metrics, qualify to get credit. Most current credit scoring models today only examine the experiences that one has using credit to make observations about that individual's potential risk of default relating to the granting of additional credit.

Certainly, how one handles existing credit is an important criteria. But, the problem is that that criterion is used to make decisions regarding the risk of default about many other people who have chosen, for any number of excellent reasons, not to have credit. That, in my mind, sets up a subjective distinction—or a partial preference-- for those that already have credit. The impact of that distinction is the true credit worthiness or credit risk of individuals that do not have credit is grossly understated. We cannot honestly say that Congressman Cleaver's maternal grandmother had a higher risk of default simply because she had no credit. Absence of credit history may be due to greater financial discipline where consumers elect not to borrow in order to live within their means. Sadly, in instances where a specific need arises, these borrowers must turn to lenders of last resort, which will be far more costly for them. The current system also rewards consumers who have come to rely on credit to support a lifestyle that puts them at greater risk for financial difficulty if there is any unforeseen or uncontrollable interruption in their cash flow.

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There are other examples of how "subjectivity" is injected in the current scoring system. Credit scoring "objectivity" is hindered by the choice and weighting of certain variables, failure to include all of the relevant categories of factors, incomplete data, and the use of historical samples that do not include the full range of possible conditions and outcomes. And, as stated above, they also specifically exclude consumers possessing little or no credit history, thus providing an incomplete picture of the total population. When these judgments are not well-founded, the impact is widespread.

Moreover, some credit models may actually be rewarding or incentivizing behavior that may not be predictive or objectively demonstrative of ability to repay. For example, most credit applications ask potential borrowers how long they have lived at their current residence. While years at one residence may superficially provide insight into an individual's stability, it would be extremely dangerous to draw conclusions about someone that has lived in multiple residences in a limited time frame. Yet, that is precisely what happens with most credit scoring models today. In fact, someone who moves may be doing so in response to a better job with a higher income—factors which are not picked up under the present system. In my view, the picture that is being presented of such a person is both underinclusive, as well as subjective as to which factors should be considered in making credit decisions about that person. Similarly, while individuals who are older and presumably have had long histories may appear to be better credit risks, in fact, these people are actually penalized by the current system when they lose a spouse (either through separation or death) if the credit was in the name of the other spouse.

In contrast, the C-CAF evaluates individuals like Congressman Cleaver's grandmother more holistically and by using parameters that are long established and accepted as providing complete benchmarks about an individual's risk profile. The starting point has to be the "Five C's of Credit". The concepts embodied by the Five C's unfortunately have been deemed to be "judgmental" factors. In this instance, the use of the word "judgment" is not used interchangeably with the word "subjective". The latter word, as we discussed above, really means a decision that is based on factors that are not impartial. Judgment, in this context, means a systemic decision that has been reached based on the consideration of all sound principles and facts, not just a few select, unrelated indicators.

So, what are the facts and principles that are at the core of the C-CAF?

*Character:* This factor expressly examines an individual's past payment record—including past borrowings and the manner in which each obligation was repaid; payment history for non-credit obligations, such as water, gas, electric, telephone, rent; education and professional certification; time in the specific professions and type of employment; and length of employment and length of

time at present address. C-CAF also accounts for recent changes and the reasons for such changes.

*Collateral*: This factor examines whether the individual has savings accounts, stock, bonds, or other investments or assets; the degree to which these assets are already pledged to cover other obligations; whether the individual has life insurance (or perhaps disability and loss of employment insurance); loan to value ratios; age of the asset(s) to be purchased and type of appraisal it received; and certain collateral attributes (including things like age of the structure and where it is located).

*Capital*: This factor examines the personal assets that the individual has that might constitute secondary sources of income; how many months of reserves the individual has; the types of liquid assets that may be available; and the borrower's net worth.

*Conditions*: This factor examines the terms and conditions of the loan to be extended (such as term, interest rate, purpose, amount); the external conditions of the labor market, the economy, and industry.

*Capacity*: This final factor examines things such as residence type and arrangement, percent and amount of savings, level of existing credit limits and degree of utilization, debt to income ratio, payment to income ratio and, finally, income. On income, the applicant must be capable of earning enough money, during the course of the loan, to be able to repay it. Besides current earnings, the outlook for earnings to continue or increase in the future is examined, as well as the mix of salary, commission, and bonus to the overall income calculation.

To continue the analogy with Grandmother Cleaver, she either would not be granted credit under traditional credit scoring, or would be charged a much higher rate. With C-CAF, she stands a better chance of receiving some credit given her strong payment history, and lower risk-based pricing as a result of substituting her C-CAF classification for her credit bureau score. We know that she has some assets that could be used for collateral (the life insurance policy), which would also provide positive insights into her credit standing. We do not, however, have enough information to proceed further because we do not know things like how much credit would she be seeking, what other sources of income exist to repay the loan, and things such as the terms, conditions and purpose for the loan.

Let's assume, for the sake of discussion, that the Five C's point in favor of lending to Grandmother Cleaver. By considering these individual factors—which have a forward looking component-- we can begin to make other determinations, such as whether loan terms and conditions are appropriate for an individual borrower like Grandmother Cleaver. C-CAF also provides each individual borrower with precise information as to why the loan was granted, or why the terms

were structured in a particular way. It provides the individual with clear insight into specific steps or action that he or she must take to improve their credit standing.

One of the hearing's principal focus areas involved asking panelists what could be done to improve the financial education of our country, and particularly for our youth. Clearly, paying bills on time is important, but it is not the only answer. One cannot now look at either the credit report or credit score and understand why individual decisions were or were not made. No amount of financial education will change that outcome unless and until the components of the credit report and the credit score are known and understood by the consumer. One important component of the C-CAF is that credit decisions are not left up to some undisclosed "secret sauce" so, in that sense, it is much more objective than traditional credit scoring methodologies.

Again, I appreciate the opportunity to clarify my comments and would be happy to provide any additional information that you or other members of the Committee would like.

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**Responses of Equifax Inc. to Questions for the Record**

**In connection with the July 29, 2008 Hearing**

**"What Borrowers Need to Know About Credit Scoring Models and Credit Scores"**

1. **What is your position on providing consumers a free annual credit score at the time they obtain their free annual credit report?**

   Equifax does not believe that providing consumers with a free annual credit score disclosure at the time they obtain their free annual file disclosure is either necessary or appropriate. Credit scoring algorithms are the property of their developers and the Congress should not mandate that these services be provided for free.

   When the Congress last examined this issue, only five years ago, it concluded that it is appropriate to charge a fair and reasonable fee for credit scores. Equifax charges a fair and reasonable fee for credit score disclosures to consumers, consistent with Federal Trade Commission guidance.

   As noted in our testimony before the Committee, Equifax—alone among the three nationwide consumer reporting systems—provides consumers requesting credit score disclosure with their Equifax FICO/Beacon score, because that is the credit score most commonly distributed by Equifax to its customers. We provide consumers the FICO/Beacon score because we believe that this score is the single most informative score Equifax can provide to requesting consumers. (Our customers, of course, are the ones who decide whether to use a score or scores in their lending decisions, which score(s) to use, and the manner in which they evaluate the score(s) as part of their lending decision process). Generation of the FICO/Beacon score is not free to Equifax, however. Equifax, for example, pays royalties to Fair, Isaac for the use of FICO scoring models. The Congress should not require Equifax to provide for free a product that it must itself pay to obtain.

   We also note that consumers are entitled to obtain free credit score disclosures from their lenders in connection with mortgage transactions pursuant to FCRA Section 609(g). In addition, the Federal Trade Commission and the Federal Reserve Board have proposed an alternative to the risk based pricing notice requirements of FCRA Section 615(h) for lenders that provide free credit score disclosures to consumers.

   The free annual file disclosure—created by the Fair and Accurate Credit Transactions Act of 2003 (the "FACT Act")—provides all consumers with the ability to review the credit file information that Equifax maintains about the consumer. This free file disclosure is in addition to other free file disclosures to which the consumer may be eligible, such as those relating to fraud alerts, adverse

actions, unemployed individuals seeking employment, recipients of public assistance, and other statutorily recognized instances. File disclosures promote financial literacy and promote the accuracy of information in a consumer's credit file. With this information, the consumer is able to review their credit file information for accuracy and is empowered to request the reinvestigation and correction of any information that the consumer may believe to be inaccurate and, indeed, this is the very credit file information from which the credit score is derived. Credit score disclosures, while informative, do not facilitate the correction of any inaccurate information that may be in a consumer's file. We believe that it is appropriate to charge a consumer a fair and reasonable fee for a credit score disclosure or any product.

2. **Currently, can a consumer access your website to obtain their stand-alone credit score without also obtaining a credit report? If they can't please explain why not allowing access to a stand-alone score is consistent with the FACT Act.**

   As discussed in our written and oral testimony, a consumer currently can obtain his or her credit score disclosure without also obtaining his or her credit file by mail request or by calling Equifax toll-free at 1-877-SCORE-11 (1-877-726-7311) or 1-800-685-1111. Stand alone credit scores are not made available to consumers through Equifax's website, Equifax.com. Information is available on the website, however, advising consumer's of their ability to obtain their scores by mail or telephone request.

   Equifax's practices are consistent with the FACT Act, which requires that stand-alone score disclosures be made to consumers upon their request. The FACT Act does not require that these requests be accepted through an internet web site, leaving the means by which requests are accepted and fulfilled to the discretion of the consumer reporting agency required to make the disclosure.

3. **What is the total number of people that have requested their free annual credit report from Equifax, either on your website or through other means, since the FACT Act was passed in 2003? What percentage of all of your consumers does this represent?**

   Equifax has requested that our trade association, the Consumer Data Industry Association, compile aggregate figures representing the total number of free annual file disclosures provided by Equifax, Experian, and TransUnion in accordance with FCRA Section 612(a) since that provision became effective on December 1, 2004.

4. **What "due diligence" do you conduct with creditors who report data to your institution to ensure that it is accurate?**

Equifax accepts information regarding a consumer's credit accounts and payment history only from those sources of credit information, including banks, creditors, debt collectors and merchants, which, either on the basis of Equifax's prior experience, or because of the particular source's reputation for accuracy, are determined by Equifax to be reliable sources of information and whose information adds value to credit granting decisions.

Equifax maintains reasonable procedures to assure maximum possible accuracy of the information it includes in its consumer reports. These procedures start when Equifax receives a request from a company to become a customer and furnisher of information. Equifax conducts an extensive investigation of those companies that apply to become data furnishers. Typically, the business submits an application for service that includes a current business license. Equifax will then conduct an on-site inspection of the business. The new customer signs an Agreement for Service that includes certifications under the FCRA and applicable state laws that it will provide accurate information, perform reinvestigations upon request, and will only obtain credit reports for a valid, permissible purpose. Equifax also runs a security check on the business and pulls a credit report on it. Each new customer is provided a unique member/subscriber number that is used with the account information they report. Equifax provides written instructions to the new customer on the use of the services as well copies of the FCRA required FTC Notices to Data Furnishers and Users of Consumer Reports.

In connection with the account information data furnishers report, the consumers' identifying information, including address, social security number, and date of birth are provided. The identifying information is used by Equifax to link the credit items to the credit file of the appropriate consumer. Equifax follows strict security procedures for the transmission of the data furnishers' account information to Equifax.

Prior to a data furnisher's account information being loaded into the Equifax credit reporting database, various tests are run to assure that the information provided is accurately reported. Equifax also has extensive quality assurance procedures to review and monitor its data furnishers reporting of information. Equifax assigns a data analyst to for each data furnisher who contacts the data furnisher if there are any questions regarding the account information reported by the data furnisher.

The data furnishers report account information in either of two credit reporting industry standard formats, Metro or Metro 2. This provides consistency and uniformity in how credit information is received and reported in the credit files.

Equifax also has detailed procedures regarding the reinvestigation of consumer disputes regarding information included on a consumer's credit file. Upon receipt of a dispute, Equifax initiates those procedures to verify the information obtained from the source, generally through the credit reporting industry developed electronic dispute processing mechanism. Equifax also maintains procedures so that when an account is deleted pursuant to a reinvestigation it will not be reinserted into a consumer's credit file.

In addition, the Federal Trade Commission and the financial regulatory agencies have proposed a rule, as required by the FACT Act, which will further define the responsibilities of data furnishers.

The accuracy of credit reports was criticized at the hearing, in part based on an accuracy study conducted by U.S. PIRG. The Government Accountability Office, however previously has questioned the reliability of various accuracy studies. "We cannot determine the frequency of errors in credit reports based on the Consumer Federation of America, U.S. PIRG, and Consumers Union studies. Two of the studies did not use a statistically representative methodology because they examined only the credit files of their employees who verified the accuracy of the information, and it was not clear if the sampling methodology in the third study was statistically projectable."[1]

5. **You testified at the hearing that your agency is beginning to use some alternative data in your credit scoring models. Precisely what types of alternative data are you using and you are not using? Are there certain types of alternative data that should not be included in credit scoring models because they are less predictive of risk?**

Equifax benefits from being able to compile robust credit files for consumers. Equifax also believes that consumers with thin files and "unbanked" consumers, including many young consumers and minority consumers, also would benefit if reliable and predictive alternative data can be added to consumer files. As such, Equifax is carefully evaluating alternative data sources for potential inclusion in our credit files and for use in the credit scoring models that we develop. In doing so, we are cognizant of our obligations under the FCRA to maintain reasonable procedures to assure maximum possible accuracy of the information we report about consumers. Further, we must be assured that the a new data furnisher will comply with the various FCRA requirements for data furnishers.

Equifax is beginning to use alternative data by evaluating and reviewing its effectiveness in the development of new score models. Examples of alternative data that we are evaluating include apartment rental payment information, telecommunications and utility payment data, and checking direct deposit account data. Our evaluation of this data for use in scoring models is ongoing. Our

[1] Statement of Richard J. Hillman, Director, Financial Markets and Community Investment, General Accountability Office, Before the Senate Banking Committee, July 31, 2003.

research to date, however, suggests that alternative data that reflects payment or lack of payment on a service received generally is the best data for predicting risk when traditional credit data is unavailable.

Once types of alternative data have been confirmed to have predictive value, alternative data types could be added to consumer files once it has been obtained from potential furnishers of that particular type of alternative data.

Contribution of information to consumer reporting agencies by data furnishers is voluntary. The traditional voluntary reporting system has served consumers, furnishers, and consumer reporting agencies well since the FCRA was originally enacted. Congress looked at the voluntary nature of the reporting system as recently as the 2003 and elected to retain the voluntary nature of the reporting system. As a result, before alternative data can be added to credit files on a large scale, it will be necessary to persuade furnishers to provide the information for inclusion in credit files and to undertake the corresponding obligations that the FCRA imposes on furnishers of information to consumer reporting agencies. In some cases, it also may be necessary to address state law limitations on the ability of utilities or other potential furnishers of alternative data to provide that information to consumer reporting agencies for inclusion in consumer reports to be made available for all FCRA permissible purposes.

6. **How is reporting high balance in lieu of credit limit consistent with the FACT Act obligation of complete and accurate consumer reports, particularly when rate utilization is a factor used to calculate credit scores?**

As discussed further below, Equifax reports both high balance or highest amount of credit actually used ("High Credit") and credit limit information, the maximum amount that the consumer can charge on the account, ("Credit Limit") when both are reported to Equifax by its data furnishers. Almost all Equifax data furnishers report both High Credit and Credit Limit.

Credit Limit information is somewhat different than other account information that is reported by a data furnisher. A Credit Limit for an account is set by the credit grantor, based on factors and determinations that the credit grantor considers appropriate based on its credit risk parameters and expertise. Accordingly, Credit Limit information is not like the other account information provided in a tradeline or in a credit report, which is information about the consumer's performance - borrowing, repaying, or filing for bankruptcy. While it is useful and valuable to have a creditor's evaluation of a consumer's creditworthiness for their account, as embodied in the Credit Limit set by the creditor, we do not believe that the fact that a creditor declines to provide credit limit is a basis for not reporting other accurate information about the consumer's performance on the account with that creditor.

Users of Equifax credit reports know if the Credit Limit for an account is reported, or if it is not reported. Equifax also reports High Credit information and it is identified as the High Credit information. Accordingly, users of Equifax credit reports know whether Credit Limit is reported on an account and can distinguish between High Credit and Credit Limit information on the account.

Since users of Equifax credit reports know if Credit Limit is reported on an account, they take this into consideration in their review of the credit file, i.e., the presence or absence of Credit Limit information on an account.

In connection with credit scores, score developers also understand the data Equifax reports and they build or adjust their credit scoring models to address whether Credit Limit information on an account is reported. For example, the Fair Isaac Corporation knows if High Credit and Credit Limit on an account are reported. Fair Isaac utilizes this information to produce FCIO credit scores that are appropriate and valid.

Equifax, as a consumer reporting agency, is required by FCRA Section 607(b), whenever it prepares a consumer report, to follow reasonable procedures to assure the maximum possible accuracy of the information concerning the individual about whom the report relates.

A consumer reporting agency's FCRA obligation for reporting accurate information, as set forth in Section 1681e(b), is met when the consumer report accurately reports the account information and clearly states what is being reported. As to this issue, the users of the report know if Credit Limit is being reported or not, understand what is being reported, and are not misled by the information contained in the report. As discussed above, this is the situation with Equifax credit reports and their users and the FCRA obligation regarding accuracy is fulfilled.

7. **Which government regulator oversees your credit scoring model(s) to ensure that they are empirically derived and statistically sound? Describe in detail how the regulator makes this assessment.**

Consumer reporting agencies and the consumer reports they furnish are highly regulated under the FCRA and corresponding state statutes. In addition, when developing scoring models, Equifax uses accepted statistical principles and methodologies as part of its development process.

Requirements that credit scoring systems used by lenders be "empirically derived and statistically sound" arise from Regulation B, implementing the Equal Credit Opportunity Act. Under Regulation B, lenders are permitted to develop their own empirically derived and statistically sound credit systems or they may utilize a credit scoring system developed by a third party. The choice of what scoring system to be used is the lender's decision and the lender is responsible for

validating the utility of the credit scoring system they elect to use based on the lender's own credit experience. Regulatory oversight of this process is the responsibility of the federal regulatory agency responsible for the activities of the particular lender. Equifax is not in a position to speak to how particular federal regulators assess use of credit scoring systems by lenders subject to their oversight.

8. **Why should "hard inquiries" for new credit be included as factors in credit scoring models? Has your research demonstrated that inquiries are predictive of risk?**

   "Hard inquiries", which generally are credit file inquiries for transactions initiated by a consumer, should be permissible as factors in credit scoring models because our research has shown that hard inquiries can have some predictive value with respect to risk. The importance of hard inquiries as a factor depends upon the scoring model used and the information that is available in the credit file being scored. Equifax developed general risk models developed with Equifax credit file information either ignore inquiries or they are given minimal statistical weight (typically less than one per cent).

9. **Is there raw data in consumer reports that are not seen by consumers because these data do not appear on their credit reports but show up on "machine readable" credit reports used by lenders and their scoring models? (Evan Hendricks, "Credit Scores and Credit Reports: How the System Really Works, What You Can Do", pp. 46-47).**

   No. There is no information in credit files reported to lenders that is not disclosed to consumers in human readable form. However, there is certain information that is disclosed to consumers that is not reported to users of consumer credit reports, such as inquiries for account reviews or in connection with a credit or insurance transaction that is not initiated by the consumer, i.e., prescreening.

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August 21, 2008

The Honorable Melvin L. Watt
Chairman
Subcommittee on Oversight and Investigations
Committee on Financial Services
U.S. House of Representatives
2129 Rayburn House Office Building
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Re: July 29 Hearing and the Reasonable Fee for Credit Score Disclosures

Dear Chairman Watt:

I am writing to respond for the record to a question you asked during the July 29, 2008 hearing of the Subcommittee on Oversight and Investigations titled, *What Borrowers Need to Know about Credit Scoring Models and Credit Scores*. Specifically, you asked me and the other members of the panel why a consumer should have to pay for a credit score disclosure. As you noted in your question, consumers may request a copy of the consumer disclosure once a year at no charge from a consumer reporting agency. Therefore, you asked for reasons why a consumer reporting agency should not also provide a credit score with the disclosure at no charge.

The answer is that credit score is an analysis of a credit report that would not exist but for the developer of the credit score model. Therefore, a credit score is the intellectual property of the developer. The developer of a credit score model makes significant investments in developing, maintaining, updating and marketing the credit score model. First, the developer will purchase millions of de-personalized credit histories. Then the developer will employ a highly-technical workforce to statistically analyze the credit histories to determine how predictive each factor in a file is of future behavior and risk. Then the developer will test the model repeatedly to determine if it is "demonstrably and statistically sound," as required by Reg. B of the Federal Reserve Board. After all of this work is done, the developer needs to find customers for this credit score before any revenue can be realized, thus marketing is a significant and ongoing cost.

Put another way, the ability to charge a fee is ultimately a fairness issue. If an author writes a book with important information, and Congress were to conclude that the author

should have to give the book away for free, the reaction would be outrage. Why should a score developer be any different than an author who creates intellectual property?

The Federal Trade Commission (FTC) looked at the issue of the price of credit scores sold directly to consumers by credit reporting agencies in the rulemakings subsequent to enactment of the Fair and Accurate Credit Transactions Act of 2003 (FACT Act). In the Advance Notice of Proposed Rulemaking (ANPR) on the Fair and Reasonable Fee for Credit Score Disclosure (November 8, 2004, Federal Register 64698 – 64702), the FTC observed that "[i]f the fee is set too low it may discourage competition on other terms of the transaction ...such as quality, service, or willingness to innovate."

At the time of the ANPR, the FTC noted that there is a competitive direct-to-consumer market for credit scores at work. This competitive market continues today. A prohibition on a consumer fee for credit scores sold by the credit reporting agencies would likely eliminate much of the current market. In the ANPR, the FTC observed that even a limit on consumer fees could disrupt the market to the detriment of consumers. Such a limit would create an unfair competitive landscape since there are other companies which are not consumer reporting agencies that would not be subject to such price controls.

In the final analysis, the FTC properly concluded that the market was adequately competitive to set a fair price for these services and declined to set a regulated, below market price. Today, Experian offers consumers disclosure of VantageScore, which is being used today by hundreds of creditors, for a fair and reasonable price of $5.95.

Many who promote the notion that consumers should be provided an annual free credit score disclosure misunderstand fundamental and irresolvable issues with such a proposal that go further than the elementary unfairness of dictating that a private company provide its product for free. Understanding these issues is critical to realizing why, during consideration of what became the FACT Act, an overwhelmingly large and bipartisan majority of the House of Representatives voted to require that a) consumer reporting agencies must provide a consumer disclosure at no charge and a credit score for a fair reasonable fee; and, b) mortgage lenders must disclose the specific score used in the transaction with the consumer at the earliest possible time.

To understand why Congress came to this conclusion, I would like to itemize these issues.

**1. Lenders use many different credit scores and other information to make decisions.**

A credit score allows a lender to quickly analyze a report and place it on a continuum from high risk to low risk. A typical credit scoring system takes the information in the credit file – and only the information in the credit file – and uses it to predict the likelihood that the consumer will pay the loan back under agreed upon terms and conditions. A credit score can be developed by a credit bureau, another third party or by the lender itself. As a result there are thousands of commercial credit scores in the

marketplace being used by lenders daily. It is a fundamental truth that a consumer does not have a single credit score, even though many would like to alter this reality by suggesting that there is a dominant score and all others are of little use.

In addition, lenders use a variety of different scores when making a lending decision. A generic risk score typically measures the risk of the consumer paying his/her obligations as agreed. Other scores may predict the risk of bankruptcy, the likelihood of an application being fraudulent, the likelihood a consumer may default on an unsecured revolving line of credit, or of being late more than 90-days on an account. Moreover a developer may design a credit score for a particular industry or kind of business, like mortgage, automotive, bank card, or credit union.

It is essential to understand, however, that lenders use more than just a credit score to make a decision. If the public policy goal of requiring a free credit score is to make the lender's underwriting process transparent, a credit score is insufficient for this purpose. As Capital One made clear in its written testimony to the Committee, lenders use multiple scores and other information from a variety of internal and external sources to make a lending decision. These factors will likely include items such as the consumer's income and assets, the value of collateral and the amount of down payment. These factors are likely to be included in a custom model used internally to make the underwriting decision. While there are many developers for custom models, the lender is always in control of which scores it chooses to use and interpret. Therefore, picking a particular score, or even type of score, does the consumer a disservice.

**2. <u>What score should be disclosed and by whom</u>?**

With so many scores being used in the marketplace, a legitimate question is which score should be disclosed. Some would suggest that the "dominant" score be disclosed. However, it must be understood that there is no single dominant score being used by all lenders and that a consumer reporting agency does not own a credit score it has not developed itself. Therefore, requiring a credit reporting agency to disclose a score that it has not developed itself would not only affect the agency's revenues as a result of lost sales, but would also require an agency to pay a royalty to the owner of whatever "dominant" score Congress might prescribe.

In addition, the FTC observed in the 2004 ANPR, that if the FTC were to regulate the price of credit scores, it would only be the scores sold by national credit reporting agencies. That would leave other companies selling credit scores to consumers that would not be affected, such as other score developers, specialty consumer reporting agencies and even financial institutions. The FTC concluded that "a fixed price may place regulated sellers (i.e.; national credit reporting agencies) at a competitive disadvantage to unregulated sellers."

This competitive fairness issue leads to who should have to provide consumers with a credit score for free. If one was to conclude that there needs to be more consumer disclosure about credit scores, then you should consider other key participants in the

lending process, specifically the lender. In fact, the FACT Act did just this by requiring credit score disclosures to consumers by mortgage lenders.

Moreover, it is important to understand that another joint rulemaking under the FACT Act – the rule regarding risk-based pricing notices – will likely result in many more free credit score disclosures to consumers. As proposed, the rule would allow lenders to either 1) provide a notice to consumers that a risk-based decision may have led to pricing of the loan at a rate significantly higher than that received by other consumers; or, in lieu of this notice 2) a disclosure of the consumer's score and the factors that led to the consumer receiving the score. This rule alone will result in significant expansion of the number of credit score disclosures provided to consumers and will significantly enhance the transparency of credit scores.

**3. Disclosure of a consumer's credit report is the best tool for ensuring transparency and for allowing consumers to understand and improve their credit histories.**

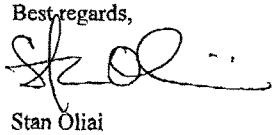
A credit score, whether derived by a credit bureau, another third party or by the lender itself, is only a numerical summary of the contents of a consumer's credit file. It is a summation of current accounts, late payments, discharged accounts, certain credit inquiries and public records that indicate a consumer's creditworthiness.

Interestingly, while developers expend significant effort in building the models, at the conclusion of this analysis, the recommendations for consumers are simple. Consumers who want to have a good credit score should pay their bills on time, only borrow what can reasonably be repaid, not become overextended on revolving debt like credit cards, and avoid bankruptcy. They should also check their credit reports at least annually and dispute any inaccurate information in the file.

It is this reality that guided Congress in its decision in FACTA to require a disclosure of the credit report at no charge to the consumer and a disclosure of the credit score to the consumer for a fair and reasonable fee.

Experian looks forward to continuing to our dialogue with the Subcommittee regarding issues of the development, use and transparency of credit scores.

Best regards,



Stan Oliai
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September 8, 2008

Mr. Thomas G. Duncan
General Counsel
Committee on Financial Services
U.S. House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

RE: July 29 Subcommittee on Oversight and Investigation Hearing entitled "What Borrowers Need to Know about Credit Scoring Models and Credit Scores"

Dear Mr. Duncan,

I am writing in response to your August 18, 2009 letter seeking answers to a number of questions relating to the July 29, 2008 hearing of the Subcommittee on Oversight and Investigations entitled, "*What Borrowers Need to Know about Credit Scoring Models and Credit Scores.*" I appreciate the opportunity to respond to your questions, by further enhancing and clarifying the hearing record. I will answer each question in the order you presented them.

**1. What is your position on providing consumers a free annual credit score at the time they obtain their free annual consumer report?**

Experian believes that consumer reporting agencies should be able to charge a fair and reasonable fee for credit scores. I addressed this question in more detail in an August 21 letter to Chairman Watt, which I have enclosed.

**2. Currently, can a consumer access your website to obtain their stand-alone credit score without also obtaining a credit report? If they can't, please explain why not allowing access to a stand-alone credit score is consistent with the FACT Act.**

Any consumer may purchase a stand-alone credit score for $5.95 through the Experian website without also purchasing a credit report. Please go to www.experian.com and select "view all products." The next page displays an option for purchasing a VantageScore.

**3. What is the total number of people that have requested their free annual credit report from Experian, either on your Website or through other means, since the FACT Act was passed in 2003? What percentage of all your consumers does this number represent?**

Experian has provided this data to our national trade association, the Consumer Data Industry Association (CDIA), and has asked CDIA to aggregate this data with the other two national consumer reporting agencies and provide it to the Committee. This data includes the number of credit reports and credit scores Experian has disclosed since the FACT Act of 2003 took effect.

**4. What "due diligence" do you conduct with creditors who report data to your institution to ensure that it is accurate?**

The Fair Credit Reporting Act requires Experian and all other consumer reporting agencies to establish reasonable procedures to assure maximum possible accuracy of the information we maintain about individuals. Part of our reasonable procedures governs the means by which we allow data furnishers to report information to Experian. For example, we require each data furnisher to explicitly acknowledge that they are subject to the obligations and liabilities of the FCRA pertaining to data furnishers. This means that data furnishers understand their duties to report accurate information to Experian and their obligation to respond when consumers dispute the accuracy of information provided by the data furnisher. As you are aware, the FTC and financial regulatory agencies are finalizing a rule required by the FACT Act that will further define the obligations of companies that furnish data to consumer reporting agencies, as well as to establish procedures for receiving and dealing with direct disputes from consumers. Finally, data furnishers must also provide business information so that Experian can perform an investigation of the company, including a physical, on-site inspection.

**5. You testified at the hearing that your agency is beginning to use some alternative data in your credit scoring models. Precisely what types of alternative data are you using and are you not using? Are there certain types of alternative data that should not be included in credit scoring models because they are less predictive of risk?**

Experian believes that the acquisition and use of certain data sets commonly called "alternative data" hold promise for helping to demonstrate the creditworthiness of individuals who do not have an existing credit file or who have a "thin" file that lacks sufficient information to score. We have conducted and sponsored a good deal of research to identify the data sets that would be advantageous to the most number of persons who fall within these categories. Because almost all credit decisions are automated, Experian believes data sets that can be easily integrated into consumer credit files hold the most promise for providing the greatest lift to consumers. These data sets include information furnished by utility and telecommunications providers. These data sets consist of highly accurate, electronic information that can be furnished to consumer reporting agencies similar to the way credit history is furnished by creditors. We have also found that this information can serve as a proxy for credit worthiness and can easily

be integrated into existing scoring systems. Stated simply, individuals who pay monthly utility or telecommunications bills on a timely basis demonstrate the same discipline as consumers who pay a monthly credit obligation on time. These alternative data sets are sufficient to assess the consumers' risk when making certain credit decisions. While there could potentially be many different sources for alternative credit data, utilities and telecommunications are generally a form of credit services utilized by almost all consumers and therefore are a potentially very important source of information. A recent study by the Political & Economic Research Council (PERC) found that fully reporting energy utility and telecommunications customer payment data to consumer reporting agencies would help up to 70 million Americans gain access to affordable mainstream sources of credit.

Despite this encouraging research, there exist marketplace and other barriers to the furnishing of data by utility and telecommunication providers. These barriers include concerns about consumer privacy and about the burdens and liabilities imposed on data furnishers by the Fair Credit Reporting Act. Experian supports efforts by the House Financial Services Committee to identify and remove barriers to the reporting of utility and telecommunications data.

**6. How is reporting high balance in lieu of credit limit consistent with the FACT Act obligation of complete and accurate consumer reports, particularly when rate utilization is a factor used to calculate credit scores?**

Experian supports complete reporting by data furnishers and encourages data furnishers to do so. However, the data reporting system is voluntary and Experian has no authority to force reporting. Some would say that creditors who do not report credit limit should be disallowed from reporting any information on the tradeline. Experian believes that to deny the ability to report any information from those data furnishers who do not report credit limit would be even more damaging to the consumer's score. For instance, a consumer who has paid a tradeline on time would likely be disadvantaged if the tradeline were excluded from the calculation of a credit score because of the absence of a credit limit.

**7. What government regulator oversees your credit scoring model(s) to ensure that they are empirically derived and statistically sound? Describe in detail how the regulator makes this assessment.**

The Federal Reserve Board's Regulation Z requires lenders to use credit scoring models that are empirically derived and statistically sound. Therefore, it is the lender – not the developer of the credit scoring model -- who is subject to government oversight regarding its use of credit scoring models. Of course, when Experian develops a scoring model for a lender, we work with the lender to ensure the lender is satisfied that the score meets Regulation Z requirements. The lender, during routine compliance oversight by its regulatory agency, must be able to demonstrate that the credit scoring model meets all of the obligations to which the lender is subject. Experian is not in a position to describe the process by which a regulator would ensure compliance with the myriad of laws

governing the lending process, which include the Fair Credit Reporting Act, the Equal Credit Opportunity Act and other applicable fair lending laws. It is important to note that while Experian may develop a score, or contribute information to a third party score or a lender's proprietary score, it does not make lending decisions.

**8. Why should "hard inquiries" for new credit be included as factors in credit scoring models? Has your research demonstrated that inquiries are predictive of risk?**

"Hard inquiries" are included as factors in credit scoring models because our research has demonstrated that they are predictive of risk. When a consumer applies for a new credit account, a hard inquiry is logged and this is retained in the consumer file for a period of two years. Credit scoring models are designed to calculate the risk these inquiries pose, while accounting for legitimate patterns indicating that consumers are "shopping around" for the best pricing and terms they can obtain. In order to account for this shopping behavior, Experian de-duplicates similar inquiries during a period of time. Hard inquiries may be an indication that a consumer has taken out new lines of credit which have not yet displayed on a credit report. A lender, therefore, needs to account for this potential risk. An excessive number of hard inquiries may also be an indication of fraud. While hard inquiries are predictive of risk, Experian has found that they typically have less relevance than other factors in the credit report. In our opinion, the media and some financial counselors pay too much attention to hard inquiries when they should be advising consumers to pay their bills on time and not over-utilize their available credit. To put hard inquiries in perspective, a few do not change a credit score significantly, but Experian has found that increasing the number of hard inquiries is predictive of greater risk. Conversely, Experian has also found that including hard inquiries in the calculation of the credit score is helpful in the case of a credit report with a few derogatory items, but the consumer was prudent in applying for new loans.

**9. Is there raw data in consumer reports that are not seen by consumers because these data do not appear on their credit reports but show up on machine readable credit reports used by lenders and their scoring models? (Evan Hendricks, "Credit Scores and Credit Reports: How the System Really Works. What you can do", pp. 46-47)**

The FCRA requires that a consumer reporting agency disclose to the consumer upon request ***all*** information in the consumer's file at the time of the request. Experian refers to this as a "consumer disclosure." Experian discloses what we refer to as a "credit report" to a user upon request under a permissible purpose certification. A credit report does not include certain information, pursuant to the FCRA, such as "soft" credit inquiries or information blocked as a result of a consumer filing an ID theft report. Therefore, the consumer would typically see **more** information than a user of a credit report. Mr. Hendricks' book discusses the potential for creditors to receive either a "merged" credit report or a "fragmented" credit report that represents information that the consumer does not see in his or her own consumer disclosure. It is important to note that Experian organizes all information about a specific consumer around a unique identifier.

When there is a request for a credit report on a consumer, Experian discloses information in that file to the user of the credit report. Therefore, in all but a few extraordinary cases the reports received by the consumer and the user of the report would have the same information -- except for soft inquiries and tradelines blocked as a result of the consumer filing an ID theft report – even in those rare instances when a file might be merged. Then, if a file contains erroneous information as a result of a merged file, the consumer may dispute the erroneous information and have it removed. Since Experian does not deliver multiple reports or fragmented credit reports on a single consumer to a user, consumers will always see the same information as a user.

**Conclusion**

In closing, I want to express my appreciation for the opportunity to assist members of the Subcommittee on Oversight and Investigations to better understand how credit scoring models are developed and how credit scores are used by the lending community. Experian looks forward to continuing to work with the Committee and Subcommittee on this topic.

Sincerely,

Stan Oliai
Senior Vice President
Experian Decision Analytics

Enclosure

WRITTEN RESPONSE OF FAIR ISAAC CORPORATION
TO QUESTIONS ON CREDIT SCORING MODELS AND CREDIT SCORES

FOR THE U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

WASHINGTON, D.C.
SEPTEMBER 15, 2008

Mr. Duncan:

Thank you for your letter conveying questions submitted by Chairman Watt as a result of the July 29, 2008, hearing titled "What Borrowers Need to Know About Credit Scoring Models and Credit Scores."

To specifically address the seven questions in your letter:

1. What is your position on providing consumers a free annual credit score at the time they obtain their free annual consumer report?

   Fair Isaac has given consumers access to their credit scores and the credit reporting process since 2001 through its myFICO.com score explanation website. In addition, we have created programs such as "Scores on Statements" which facilitate a lender's ability to provide their customers, for no charge, with access to the FICO® scores they use in their lending decisions. Through these channels, tens of millions of consumers have already taken steps to obtain informative, actionable credit information services and to help improve and protect their overall financial health. We believe consumers benefit from knowing and understanding their credit score and how it is used by lenders in their credit decision process.

   Should a decision be made to provide consumers with a free annual credit score at the time they obtain their free annual consumer report, we believe the following parameters are critical to effectively fulfill the consumer empowerment objective:

   - In the same way that the free annual credit report has value to consumers because lenders use that same credit report information to help them make credit decisions, so does a credit score have value to consumers if it's a score that lenders use to help them make credit decisions. For this reason, the free annual credit report should be accompanied by a score from a scoring model that is used most widely by lenders. An educational score or credit bureau score not widely used by lenders will provide little value to the consumer, and confuses consumers. In fact, if a consumer were to take steps to improve a little-used credit score he or she receives, those steps may not have the intended effect on the credit score that lenders actually use.

   - Disclosure of the credit score number alone will provide no indication of whether that credit score is favorable, unfavorable, or average when compared to credit scores of other consumers. The score should be accompanied by the meaning of the score as described in a graphic representation of the distribution of credit scores (i.e., the proportion of consumers who have credit scores within the specified ranges), a statement about how the consumer's score compares to the scores of other consumers, and an explanation of key factors that adversely affected the score received.

2. How did Fair Isaac determine the weight given to factors (e.g. payment history, outstanding debt) used in FICO scores?

   The FICO® scoring model is data-driven. Developing the FICO scoring model requires two samples of credit reports two years apart for the same randomly selected depersonalized set of consumers, provided by one of the national consumer reporting agencies. With this data, our scientists analyze the data in the earlier data set using statistical methodologies to isolate and prioritize factors that consistently predict the credit account performance noted two years later in the later data set. Hundreds of factors are evaluated to determine the most effective combination that will predict credit performance. These factors form the basis for a complex mathematical algorithm which becomes the predictive scoring model. The traditional FICO scoring model evaluates five types of data elements from consumer credit reports: 1) payment history, 2) outstanding debts, 3) length of credit history, 4) pursuit of new credit, and 5) mix of types of credit. The contribution of each type of data element to a typical consumer's FICO score is approximately: payment history (35%), outstanding debt (30%), length of credit history (15%), pursuit of new credit (10%), and mix of types of credit (10%).

3. At the hearing, you testified that Fair Isaac used high balance for the credit limit if the credit limit information is not reported by credit card issuers. How is reporting high balance in lieu of credit limit consistent with the FACT Act obligation of complete and accurate consumer reports, particularly when rate utilization is a factor used to calculate credit scores?

   As Fair Isaac is neither a lender nor a consumer reporting agency, we do not report information, nor do we create or maintain credit files. We build our credit scoring system using the most predictive data available to us. We take no position on whether reporting high balance in lieu of credit limit is consistent with the requirements of the FACT Act.

4. Are credit scores developed for individual lenders, often referred to as "subscriber scores" also available to consumers? If not, explain why.

   We are not familiar with the term "subscriber scores", but assume you are referring to what is commonly known in the industry as "custom scores." Custom scores are typically developed on data about only those applicants who applied for credit with that particular lending institution in the past. Custom scores evaluate the lender's experience with its own customers regarding whether or not they paid as agreed over the life of the loan.

   Disclosure of custom scores could result in a very high degree of confusion for consumers because there are so many customer scoring models and they each have different scales, factors and weights that are specific to that lender.

5. Why should "hard inquiries" for new credit be included as factors in credit scoring models? Has your research demonstrated that inquiries are predictive of risk?

   Fair Isaac research consistently shows that consumers searching or applying for new credit are riskier borrowers compared to consumers who are not actively seeking new credit, irrespective of whether new credit is ultimately granted. For example, statistically, people with six inquiries or more on their credit reports can be up to eight times more likely to declare bankruptcy than people with no inquiries on their reports. This is why the FICO score includes in its calculation the inquiries that lenders make for consumer's credit reports or scores when consumers apply for credit. However, FICO scores consider inquiries carefully as there are different types of inquiries and not all inquiries are related to credit risk.

   *Some background on this subject may be helpful:*

Many types of inquiries are ignored when calculating a FICO score. The FICO score does not count or consider inquiries that represent consumers' requests for their own credit reports or credit scores from a credit reporting agency or affiliate. Also, the FICO score does not count inquiries that lenders make for credit reports or scores in order to make "pre-approved" credit offers, or as part of managing their existing customers' accounts. Inquiries that are made for purposes of employment decisions are also not counted.

The FICO score accommodates for "rate shopping." The FICO score has special inquiry logic that is used when consumers rate-shop among multiple lenders for the purpose of obtaining a single loan. The use of that logic is driven by inquiry codes used by lenders when requesting credit reports or credit scores to the three national credit bureaus.

Rate shopping for a mortgage or auto loan are two examples of consumer activity that would drive the use of this special inquiry treatment logic. This reflects Fair Isaac's analysis of the impact these types of inquiries have on a consumer's propensity to repay debt. Based on that analysis, Fair Isaac has found that the special inquiry logic is more accurate than other analytic approaches. For these types of inquiries, the FICO score ignores all inquiries made in the 30 days prior to scoring. In addition, the score reviews the consumer's credit report for rate shopping inquiries older than 30 days. If it finds any, it counts all those inquiries that fall in a typical shopping period as just one inquiry when determining the person's score.

This rate shopping treatment does not apply when a consumer is seeking to open multiple lines of new credit – for example, applying for multiple retail credit accounts.

The FICO scoring model is data-driven. While in general more credit inquiries for new credit reflect a lower likelihood of repayment, the research has also shown that the special inquiry logic is a more predictive way to evaluate rate shopping inquiry information.

6. Which government regulator oversees your credit model(s) to ensure that they are empirically derived and statistically sound? Describe in detail how the regulator makes this assessment.

   Fair Isaac is regulated at the federal level by the Federal Trade Commission. We have a regular, ongoing dialogue with the FTC in which we explain our products and practices. In addition, Fair Isaac frequently interacts with senior officials and examiners at those entities that regulate lenders' use of credit scoring (the Federal Reserve Board, the Office of Thrift and Supervision, the Federal Deposit Insurance Corporation, the Office of Management and Budget, the Federal Housing Administration) regarding our credit scoring methodologies, validations, and scoring research.

7. Although the "Next Generation" scoring model was rolled out in 2001, not many lenders and investors adopted it and instead continued to use older versions. Because there can be variations between older and newer FICO models that can lead to substantial differences in scores, why does Fair Isaac continue to allow creditors to use older versions and continue to provide support for them?

   FICO scoring models were first introduced in 1989. Fair Isaac has frequently enhanced and redeveloped these models to ensure that FICO scores remain highly predictive and reflect trends in consumer credit behaviors, reporting enhancements and new predictive technology. In fact, since their inception our FICO scoring models have been updated a minimum of five times at each of the three credit reporting agencies. We developed the most recent versions after the introduction of NextGen FICO scores. We are in the process of redeveloping and releasing to market the next update of FICO scores (referred to as FICO score 08).

   The "Next Generation" FICO scoring model (NextGen) was created by Fair Isaac in the early 2000's as an enhanced credit bureau scoring product with different features compared to the FICO score.

While many lenders have adopted "NextGen," the majority of lenders continue to rely on the FICO score version for use in their credit decision processes because converting to NextGen presented many challenges.

In response to market demand, Fair Isaac actively supports both NextGen and FICO versions and we are committed to providing the lending community with highly predictive credit bureau scoring systems. We believe that most lenders will migrate to the latest versions of FICO scores once they have completed a rigorous validation and testing process. One result of this process is that there are multiple versions of FICO scores in production at any given time so that all lenders can continue to access FICO scores as they conduct their transition work.

* * * * *

We very much appreciate you contacting Fair Isaac to convey Chairman Watt's questions and we truly hope this information meets his need for additional information..

Sincerely,

Tom Quinn
Vice President – Systems Integration
Fair Isaac Corporation



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