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KEEPING SCORE ON CREDIT SCORES: AN OVERVIEW OF CREDIT SCORES, CREDIT REPORTS, AND THEIR IMPACT ON CONSUMERS

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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KEEPING SCORE ON CREDIT SCORES: AN OVERVIEW OF CREDIT SCORES, CREDIT REPORTS, AND THEIR IMPACT ON CONSUMERS

Wednesday, March 24, 2010

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:04 p.m., in room 2128, Rayburn House Office Building, Hon. Luis Gutierrez [chairman of the subcommittee] presiding.

Members present: Representatives Gutierrez, Sherman, Moore of Kansas, McCarthy of New York, Green, Miller of North Carolina, Scott, Ellison, Perlmutter, Speier; Hensarling, Royce, Garrett, Price, Campbell, Marchant, Paulsen, and Lance.

Also present: Representative Kilroy.

Chairman GUTIERREZ. This hearing of the Subcommittee on Financial Institutions and Consumer Credit will come to order.

Good afternoon, and thanks to all of the witnesses for agreeing to appear before the subcommittee today.

Today's hearing will examine how consumer reports and scores are created, how they are used in today's financial services economy and the impact they have on consumers.

This hearing will also focus on reports completed by the Federal Reserve and the Federal Trade Commission pursuant to the requirements of Section 215 of the FACT Act.

We will be limiting opening statements to 10 minutes per side, but without objection, the record will be held open for all members' openings statements to be made a part of the record.

We may have members who wish to attend who do not sit on this subcommittee. As they join us, I will offer a unanimous consent motion for each to sit with the subcommittee and ask questions when time allows.

I yield myself as much time as I may consume.

As we begin this hearing on credit scores and reports, we must recognize that the American consumer faces a very different landscape than 30 years ago.

Credit cards are so widespread that they are routinely marketed to college students. Your local bank, that is if you are lucky enough to have one in your neighborhood, is more than likely owned by the same faceless Wall Street corporation from which you can shop for

loans and car insurance online, something that was not even imagined 30 years ago.

In large part, what has made all this possible are the now ubiquitous credit scores and reports created and provided largely by companies that sit before us today.

Driven by an increasingly impersonal and homogenized lending environment, lenders, insurance companies, utilities, and even cell phone companies are relying more and more on credit scores and reports to determine whether a consumer is worthy of their attention and indeed their services.

I know the increased use of credit scores has expanded credit to previously ineligible borrowers and the standardization of the system has minimized some of the bias present in our economy, but the system has created new concerns and dangers for consumers, especially if you are Black or Latino, that we should address.

A good credit score and of course, favorable credit reports, have become the passport to a stable economic future for today's consumer.

These passports are being issued by thousands of private, for-profit companies that few can identify using opaque formulas that are hidden from the American people and hidden from Congress.

In a democracy, there is something unseemly in having one's life judged and possibly even guided, no matter how benignly or unintentionally, by private, for-profit companies to assist them where it is impossible for one to opt out.

This fact alone causes me to doubt the fairness of our current system and structure. For instance, as Mr. Hendricks will mention in his testimony, consumers are not commonly allowed access to the scores that lenders and other financial consumers of data actually use to make lending decisions.

Let me repeat that. For instance, as we will hear in testimony today, consumers, Americans, are not commonly allowed access to the scores that lenders and other institutional consumers of data actually use to make lending decisions.

Instead, you are sold an "educational score." That is not the score used by the lenders to determine necessarily your credit card rate and can be different than that used to determine the rate for qualifying.

What is going on is they are selling you a product that is never really used to make any decision about your creditworthiness. How is that educational?

On top of that, lenders use their own private data to further determine what rate or fee they want to charge a consumer. For an industry that is supposed to be focused solely on accuracy and predictability, there seems to be quite a bit of effort going on behind the scenes to prevent consumers for seeing things as they really were.

Americans do not know where these scores are coming from and how they are created. I have strong reservations about allowing the use of credit reports to determine employability and insurance fees.

For example, 22 percent of Latinos in America have "thin files" and are given a worse rate for loans and insurance and can even lead to them being rejected for a loan.

At a time when Americans are dealing with 10 percent unemployment rates, which is in fact higher in many communities across America, I do not believe that our constituents should have to worry about whether or not their credit report is entirely accurate or even worry about it when they should be focused on finding a new way to pay their rent and feed their kids.

We should not allow the secrecy of our current system to affect consumers' livelihoods without their knowing the rules of the game and what they can do about it before it is too late.

Consumers should know that a medical debt that they already paid off will affect their credit for 7 years to come, or that being away on military service in Iraq, in Afghanistan, protecting this country, might not be much of a mitigating factor for the credit bureaus and institutional consumers of credit scores and reports, or recent immigrants' creditworthiness is often lower than the general population, regardless of how good their credit history was in their home country.

These are just some of the concerns that make it clear that the current system has not reached acceptable levels of fairness or transparency.

Finally, I have concerns that with banks and others taking credit away from consumers due to the bank's own problems, not those of the consumer, your formulas are not accurately predicting a consumer's true likelihood of default.

Just because some bank is consolidating their credit lines they have out there for all their consumers, it does not mean that every single one of them is a greater credit risk.

There are many legislative proposals circulating right now on credit scores and reports, some I have co-sponsored and some I plan to introduce myself.

We will be holding further hearings on these proposals after we give a harder look at credit-based insurance scores in the near future.

Many of these concerns that I have are with institutional consumers of credit scores and reports, so I can assure you that we will be inviting them to sit down and have their own discussion with our subcommittee about this as well.

I guess basically I do not know if I am a good driver of a car, but I check the locks on my house every night. I make sure the electricity is up-to-date, the gas is working right, I have my roof. Why I should pay more for my insurance on my house?

I go 55-miles-per-hour in a 55 zone. I do not go through red lights. I put my turn signals on when I am supposed to, and I am a good driver. I do not think I should pay more for car insurance.

Yet because people are using credit scores, if I am one of those 40 million Americans without health care insurance or the tens of millions of Americans without any job, and I become ill, for 7 years, that illness—I was just thinking before I came up here, when I was in school, I used to be able to go to the teacher and say, "I was out for 2 weeks, I was sick." She gave me time to make up so I could study, so there could be a true reflection of who I was and what grade I should receive.

In America, if you get sick, you just cannot take a sick card or a note from your doctor to the credit bureaus and say, "By the way, do not tell everybody I am a bad credit risk, I was sick."

If that is the way we dealt with employment, at the end of the year, I know that if I had an employee and they were sick in the hospital, I mean sick, they were gone for a couple of months, I do not think I would evaluate them on their absence during those 2 months.

Yet credit scores are routinely used if people get sick because for 7 years, it takes. Some say oh, well, they did not pay it. Well, they were out of a job. They were sick. It was something beyond their control. They were ill.

In America, I just think a credit score should not be used for that, especially when it is going to determine how much you pay for other products, not for a job.

If you are in a job interview, you might be able to explain, but you do not know because someone somewhere is using that.

With that, I am going to close my opening statement, and yield to Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman. I cannot help but notice the television camera that is facing us. Hopefully, there will be a number of insurance companies in the market who know you are such a good customer and there will be more competition for your business and you will get a better rate.

I would hope that indeed you and other members of your party would support legislation to make these markets more competitive instead of less competitive.

I believe I heard you correctly in your statement saying that you were fearful that consumers are ending up in a system where it is impossible for consumers to opt out. To some of us, it sounds a little bit like the health care bill that was passed on Sunday. It will be very difficult for consumers to opt out indeed.

Nonetheless, I appreciate you calling this hearing, Mr. Chairman. I think it is very important that we talk about the role that credit scores and resources play in our economy. Clearly, when there is information that is accurate, credit scores have done a lot to help consumers throughout our economy. They have proven to be doors of opportunity for all demographics and geographies.

When you think about it, through a simple number, there are people throughout America—consumers are empowered by a simple number, with the opportunity to borrow from a lender that they never met, and in order to buy a house, a car or any number of items that in past years, they would have had to save for weeks, months, or years before they could purchase that particular item.

I think that the modern credit score has certainly helped democratize credit throughout our society and I think all and all, this is a very good thing.

If we allow the data companies to process the scores properly and reporting agencies are able to compare people with similar characteristics or borrowers that might hail from different backgrounds, yes, you do have a democratization of credit.

The retired school teacher and grandmother of three in Mesquite, Texas, whom I am able and privileged to represent in Congress, is able to access credit as well as maybe the union construction work-

er from your district, Mr. Chairman. Their creditworthiness is now determined through an impartial formula.

The linchpin of the system that goes into determining the credit score has to be complete. It has to be accurate. Otherwise, the outcome is going to be misleading, and frankly, I think ultimately that hurts the consumer.

A lot of work has been done. I know we were both on this committee as the FACT Act was passed in 2003. I look forward to hearing the testimony, listening to your witnesses on their reaction to that Act, any suggestions they may have.

I am still somewhat fearful that this hearing may be leading to a movement to somehow make credit files thinner. I am not sure that is going to be helpful. Number one, to me, the thicker the file, the more it gives lenders a complete picture of the customer, and they are more willing to lend.

Ultimately, I think that brings down the costs of credit and I think it makes the availability of credit even greater. At least my research into history shows that before the advent and wide use throughout our economy of credit scores, again, that is exactly what we saw, less credit.

If we go down the road of thinner files, several things are going to happen. Number one, some people are going to be denied access to credit that they could otherwise access through the market.

Some will have to pay more for credit. Others, as we get away from any kind of risk-based pricing, we will have yet another bailout foisted upon us by the United States Congress for those with good credit scores ending up to bail out those with bad credit scores. I certainly do not see the merit in that.

Finally, I really question the wisdom and propriety of the United States Congress essentially gagging those who wish to exercise their right to offer opinions about the creditworthiness of their fellow citizens.

We should tread very lightly before we trample upon commercial free speech. I think we need to look very, very carefully before we go through that.

Again, if we just look to the recent credit card legislation where some of us said, if you end up passing this thing, it is going to lead to higher interest rates, more fees, and less credit. Sure enough, the law was passed, and that is exactly what happened.

I know there are many instances that adversely impact certain individuals, as the chairman described. I am not sure that the congressionally mandated law that says all of a sudden a for-profit company has to engage in a charitable business that they may not want to engage in.

I would think the answer would be to help the individual involved and put it on budget. This is a nation going bankrupt as is, doubling the national debt in 5 years, tripling it in 10 years.

If we are going to do this, we ought to at least put it on budget and start making decisions on priorities.

Mr. Chairman, I appreciate you calling the hearing and I look forward to hearing from the witnesses. I yield back.

Chairman GUTIERREZ. Mr. Garrett is recognized.

Mr. GARRETT. I thank the Chair. I thank all the witnesses. I will be brief. Before I begin, I will just say I, too, as the gentleman from

Texas, was taken aback by the chairman's comment with regard to the private market and democratization, the idea that we should have the ability to opt out of this segment of a market.

As the gentleman from Texas said, just 3 days ago we said, if you were born in this country, you are a citizen of this country, you cannot opt out of what was just passed for the first time in U.S. history, the requirement that you buy a particular product approved by the Federal Government over which you have absolutely no direct control as to whether you want to or not, as the price of citizenship.

Would be that is true, that the chairman continued his reasoning to the health care bill to allow Americans to opt out of that plan or allow the States to opt out of that program, and when the chairman speaks of secrecy versus transparency, my gosh, I do not think there is anyone back at home or in Congress who actually knows the faceless bureaucrats who will not be imposing the citizenry of this country the requirements of their health policies and their health care going forward.

Perhaps we should set priorities and say let's have transparency and openness and the ability to opt out in something even more personal and intimate as our health care as opposed to getting into regulating the credit markets.

With that said, I can just say I was here about 6 years ago when I first came into Congress, my first year was 2003. At that time, Spencer Bachus was the Chair of the Financial Institutions Subcommittee, and that is when we passed the Fair and Accurate Credit Transaction Act, the FACT Act. That law made a number of important changes, as you know, to the reporting laws. It allowed consumers to have easier access to credit information as well as what we are looking for, and that is improve the accuracy of that information.

During that time, credit scores had become an essential and valuable tool in allowing creditors basically to more accurately price for risk. That is really what it is all about.

Unfortunately, many of my colleagues on the other side of the aisle do not agree with the idea of risk-based pricing, whether it is the FHA loans or credit cards.

If you do not allow a company to price for risk, you know what the end result is going to be. It is going to be one of two things: either you will decrease credit availability for some folks; or you will increase the cost of credit for other people.

I believe that this committee should work closely and examine closely and be careful in our deliberations before we take any actions that could lead to less accurate credit scores and higher costs or less credit for consumers.

Finally, the use of accurate credit scoring basically allows consumers to do what I think most of them want to do, and that is to manage their financial affairs and provide better control, not less, to the consumers.

Credit scoring is a useful function of the markets and therefore, it should remain free of unnecessary government regulation. When you get right down to it, the very best way to ensure consumers have access to credit and to the financial freedom that they need

is to develop policies here in Congress that will focus on economic growth and job creation as well.

With that, I yield back.

Chairman GUTIERREZ. The gentleman yields back. We have the first panel here: Mr. Evan Hendricks, editor and publisher of Privacy Times; Mr. Stuart K. Pratt, president and CEO, Consumer Data Industry Association; Mr. Tom Quinn, vice president, Global Scoring Solutions, FICO; Mr. Barrett Burns, president and CEO, VantageScore Solutions; Mr. Chet D. Wiermanski, global chief scientist, Analytic Decision Services, TransUnion; Mr. Stan Oliai, senior vice president, Decision Sciences, Experian Decision Analytics, Experian; Ms. Myra K. Hart, Ph.D., senior vice president, Analytics Services, Equifax; and Ms. Anne P. Fortney, partner, Hudson Cook LLP.

We will begin with Mr. Evan Hendricks for 5 minutes, please.

STATEMENT OF EVAN HENDRICKS, EDITOR/PUBLISHER, PRIVACY TIMES

Mr. HENDRICKS. Thank you, Mr. Chairman, and Ranking Member Hensarling for the privilege to appear before the subcommittee. I would like to run through about a dozen points in my 5 minutes.

First, on credit scores. The Congress did pass a really good law in 2003, the FACT Act, the amendments to the Fair Credit Reporting Act. They have been very helpful to consumers and I think it makes for a better industry.

I think one of the great things it did is it made consumers eligible for one free credit report per year, which is something that millions of people have taken advantage of, and for commerce, the credit bureaus have sold twice as many credit reports as they have given away, when you include monitoring services.

I think we need to take the next step. Consumers should be entitled to one free credit score per year. That credit score should be one that is used by lenders, not a so-called "educational score," which the chairman cited.

In our free marketplace, companies are going to continue to sell educational scores, which sometimes we call "knock-off scores" or since they are not real FICO scores, we call them "FAKO" scores.

If they are doing that, they should have to disclose that they are selling a score that is not used—first, to say are they used by any lenders. If they are not used by any lenders or are they even used by a significant number or a majority of lenders.

The last thing on credit scores, this is not in my prepared statement, so I apologize and I will submit something, there are two important fixes that I think this committee could achieve and actually, a lot of people would agree on.

The problem is Fannie Mae. Fannie Mae has adopted a policy that if someone has a disputed account on their credit report, they are holding up loans and really making it hard for consumers to get loans. I have written about this and Ken Harney has written about it in his syndicated column.

I think Fannie Mae should be made to justify that policy because I do not think there is a basis for it and it is hurting consumers and it is stopping loans from going through to creditworthy people.

The other thing is that FICO scores took off in the 1990's because Fannie adopted one of the early versions of FICO scores. Now, there is a much better version called "FICO 8."

If Fannie would move forward and adopt that, that would be something that would really improve, because there are many things which Mr. Quinn maybe could talk about as to why that is a better score.

In terms of accuracy, there are two important standards in the Fair Credit Reporting Act. One is you have reasonable procedures for maximum possible accuracy. The problem there is we still have the same sort of inaccuracy problems that we saw 20 years ago.

I think it goes to a fundamental issue. Our three major credit reporting agencies often like to think of themselves as libraries and simply passively taking information from creditors and then just passing it on, when in fact the law sets a standard that they have a grave responsibility to ensure accuracy. I do not think they live up to that on very important occasions, especially with mixed files and identity theft, causes of serious inaccuracies that are harmful to consumers.

Possibly even a bigger problem is the dispute process. Naturally, companies want to automate, but the credit bureaus have automated to the extent that a consumer makes a dispute and there is a computerized exchange of messages, and the law requires a re-investigation, but the way they do this computerized exchange of messages, it does not amount to a real re-investigation. This is something that is playing out in the courts over and over again.

Therefore, inaccuracy continues to be a major problem. The Federal Trade Commission is supposed to be getting ready to do a major accuracy study. So far, they have not done a good job with their pilots.

I think it is worth noting that independent groups have done studies, but the credit bureaus themselves have never done an accuracy study, at least in the last 15 years, and they are the ones sitting on all the data.

We have another issue because of technology and because of entrepreneurship, that we have a lot of medium- and small-sized consumer reporting agencies popping up, but a lot of times consumers do not know they are there and they do not know what they do, and sometimes they get ambushed by them.

I think that considering the proliferation of all these little consumer reporting agencies, we should have a registration requirement. If you are subject to the Fair Credit Reporting Act, we need to have a comprehensive list of who is gathering data on us so people can exercise their rights of access and correction.

One example of this that I uncovered recently is called the National Consumer Telecom and Utilities Exchange. This is an exchange run by the utility companies where they are keeping records on people who have not paid their utility bills, and then they are screening new applicants against this, but it was not clear to the extent that consumers were getting adverse action notices and finding out, as required by the Fair Credit Reporting Act, if this was a basis for them being denied.

I would like to see some transparency there. Originally, they would not answer a lot of the questions I had for them.

Employment background screening, I will just say this, there are a lot of sort of start-up companies that will do a background check on someone based on simply a name and a date of birth.

That means there are times where I have seen someone like Deborah Adams apply for a job but lose the job because they found another Deborah Adams with a felony record. She never had a felony. Someone else like Thomas Payne was another person that I saw.

Chairman GUTIERREZ. The gentleman's time has expired.

Mr. HENDRICKS. Okay. Thank you.

Chairman GUTIERREZ. Thank you.

[The prepared statement of Mr. Hendricks can be found on page 124 of the appendix.]

Chairman GUTIERREZ. I want to mention that in the interest of time, and as agreed by all parties, Mr. Pratt will testify on behalf of his association and the three credit bureaus, but they have all submitted written testimony and are here to answer questions.

Mr. Pratt, you are recognized for 5 minutes.

STATEMENT OF STUART K. PRATT, PRESIDENT AND CEO, CONSUMER DATA INDUSTRY ASSOCIATION, ACCOMPANIED BY MYRA K. HART, PH.D., SENIOR VICE PRESIDENT, ANALYTICAL SERVICES, EQUIFAX INC.; CHET D. WIERMANSKI, GLOBAL CHIEF SCIENTIST, ANALYTIC DECISION SERVICES, TRANSUNION LLC; STAN OLIAI, SENIOR VICE PRESIDENT, EXPERIAN DECISION ANALYTICS

Mr. PRATT. Mr. Chairman, and members of the subcommittee, thank you very much for this opportunity to appear before you today. I would like to just focus on a few key issues in my oral remarks, and let's start with the importance of preserving and expanding data for risk decisions.

Our members' databases preserve an invaluable history of how we manage our finances: 18,000 data sources update 3 billion data elements every month.

This Congress, by enacting new laws, calling for creditors to do even more to assess a consumer's ability to repay a loan has recognized the value of these data systems.

While it might be tempting to eliminate certain data due to the severity of the recession, it is vitally important to preserve the totality of every consumer's credit history. In fact, to prohibit data sources from furnishing data, to require furnishers to delay the furnishing of data, or to prohibit a user from analyzing certain data, all are wrong choices.

We now know that we must expand data resources which tell the consumer's story. For example, we must ensure that we can verify a consumer's income. We must report on utility and telecom payments. Lenders should know whether a consumer owns his or her home outright.

Turning to scores, no nation has such a competitive and innovative market for the development of credit scores. This industry is a U.S. core competency. It is no mere feat to build a credit scoring system; years of research and development and millions of dollars go into this. The resulting software is intellectual property protected by the USPTO.

Credit scores are designed to estimate the relative risk of my likelihood of repaying a loan or to predict some other credit behavior. Use of credit scores benefits all of us. Credit scores help lenders lower prices and they help remove even unintentional biases in the marketplace.

It is the precision and objectivity which the score brings to the table which makes it such an integral part of our Nation's lending process.

With this basic information about scores in mind, let's now turn to the consumer perspective. Behind every credit score is a credit report. As we all know, in December 2004, our members went live with a free credit report delivery system, and as of now, more than 150 million credit file disclosures have been issued.

In addition to the incredible number of consumers who have reviewed their credit reports, consumers also know more today about their scores than at any point in history.

Whenever a consumer assesses a score, it is a teachable moment. The reason for score disclosure is educational. Consumers learn about how scores work and most importantly, what matters most in their credit report.

Some have expressed concern about which scores are disclosed. We think they have missed the mark for a number of reasons. There is not just one score used by all lenders. It is wrong to leave consumers with that false impression. Various lenders use various scores.

Scores are not the final word in a lending decision. In previous testimony, one lender said "We use external credit scores and scores developed internally based on our own lending experience."

Further, all scores our members disclose are production scores used by real lenders. In the end, consumers should understand that the data in their credit report is the one constant. Every lender is going to use this data to make a lending decision regardless of the score used.

Some have also suggested that nationwide consumer credit reporting agencies should provide consumers with scores free of charge. We do not agree. A consumer pays a fee to have an appraiser assess the value of his or her home. Consumers will pay for a software program to produce a tax filing. No one is suggesting these services be offered for free.

Congress, in enacting the FACT Act, recognized the difference between giving consumers free access to their credit report disclosure and giving them access to scores at a reasonable fee.

This same Congress recognized that it could be beneficial for consumers to have access to the score used by a lender in a given transaction and require score disclosure with all mortgage loans.

Further, as a result of the newly finalized FACT Act risk-based pricing notice rule, consumers will now have an opportunity to see the score used by the lender for any type of loan. This expansion of the credit score disclosure by a lender is a positive result for consumers.

It is our view that there is no need to create new score disclosure requirements. Consumers have clearly benefitted from their right to free credit file disclosures. Consumers have benefitted from the use of scores by lenders, which ensures fairness and lowers prices.

Consumers have benefitted from the extensive choices of access they have in the marketplace today.

Mr. Chairman, we thank you for this opportunity to testify and I look forward to answering your questions.

[The prepared statement of Mr. Pratt can be found on page 150 of the appendix. The prepared statement of Mr. Wiermanski can be found on page 193 of the appendix. The prepared statement of Mr. Oliai can be found on page 139 of the appendix. The prepared statement of Ms. Hart can be found on page 118 of the appendix.]

Chairman GUTIERREZ. Thank you so much. We will have a second panel with witnesses from the Federal Reserve Board and the Federal Trade Commission. We will now hear from Mr. Tom Quinn for FICO.

Mr. Quinn, you are recognized for 5 minutes.

STATEMENT OF THOMAS J. QUINN, VICE PRESIDENT, SCORES, FICO

Mr. QUINN. Thank you. Mr. Chairman, and members of the subcommittee, my name is Tom Quinn. I am vice president in the SCORES Division of FICO, formerly Fair Issac Corporation, responsible for the management and delivery of the company's global scoring products and services.

Thank you for the opportunity to testify before you today on this important topic.

FICO is the leading provider of analytics and decision management technology. Although we offer a wide array of market leading products and services, our company brand remains most closely tied to the FICO score, which was first introduced in 1989.

Today, FICO scores are the most widely used credit bureau risk score in the world, powering over 10 billion credit decisions.

In the context of today's hearing, we hope it is clear that FICO is a developer of credit scoring models. We are not a credit bureau and we are not in the business of compiling consumer credit reports.

Our analytic scientists develop FICO credit scoring models in the form of a mathematical formula called "algorithms." These algorithms are housed at each of the three credit bureau repositories.

When a lender requests a FICO score, the credit bureau feeds the consumer credit report information into the algorithm, the score is generated, and then output to the lender for decisioning.

While my written testimony goes into greater detail, I wanted to highlight a few key areas related to the FICO score.

The FICO score is a 3 digit number ranging from 300 to 850. The score rank orders consumers by the likelihood that they will become seriously delinquent, meaning 90 days past due or greater in the next 24 months on credit obligations. The higher the score, the lower the risk.

FICO scores are used by businesses across a range of industries to help assess a consumer's creditworthiness. When a consumer applies for a car loan, a mortgage or a credit card, the lender may check the consumer's FICO score to help determine if they are going to approve or decline and what terms they may set with the loans, such as pricing and credit line.

However, FICO scores are usually only one of several key factors considered by lenders. Traditionally, responsible lenders use other information considered as the three "Cs:" creditworthiness; capacity to pay; and collateral. The FICO score addresses the first of those, creditworthiness.

FICO scores are objective and data-driven. Our analytic scientists study large representative national de-personalized samples of credit data from each of the credit reporting agencies to isolate and prioritize factors that consistently predict credit account performance.

Those factors found to be most powerful and consistent in predicting credit performance, both individually and in combination, form the basis of the complex mathematical algorithms which become the FICO scores.

The FICO credit risk score is not static. It undergoes continuous innovation. FICO regularly studies credit bureau data samples to test the predictive value of the factors considered by the FICO score.

Through empirical analysis of the data, FICO has consistently updated its algorithm resulting in a more predictive scoring model. In fact, our latest scoring model, FICO 8, which was referenced by Mr. Hendricks, generates the most predictive FICO score to date.

At FICO, we understand and we appreciate the importance of an educated consumer. As a result, we have demonstrated a strong commitment to providing freely accessible educational resources related to credit scores and credit related topics.

On our MyFICO.com Web site, you can not only purchase your FICO score for a modest fee, but you can also gain access to a wealth of credit information about how credit works, in addition to a detailed explanation of how your FICO score is derived and a program that helps consumers determine whether they qualify for government-sponsored mortgage relief.

Also, we supported the creation of an active online consumer forum in which a community of 340,000 registered users gather online to discuss credit scoring topics and to help each other understand what they can do to improve their FICO scores over time.

In addition to our Web presence, FICO staff work with a wide range of Government officials and consumer nonprofit agencies and groups providing education and training related to credit scoring topics and matters.

All of this is consistent with our long-held commitment in empowering consumers to manage their credit health.

Credit scores are not static. They are constantly changing based on consumer credit behavior. There are no shortcuts to rapidly raising a low score, but smart practices like consistently paying bills on time, keeping your credit balances low, and only applying for credit when needed will help to lift your score over time.

Consumers who commit themselves to healthy credit habits and sound financial management practices are likely to see their credit scores improve over time.

I appreciate the opportunity to testify before you today. Thank you.

[The prepared statement of Mr. Quinn can be found on page 169 of the appendix.]

Chairman GUTIERREZ. You are very, very welcome.

Now we have Mr. Barrett Burns, president and CEO of VantageScore Solutions. You are recognized for 5 minutes, sir.

STATEMENT OF BARRETT BURNS, PRESIDENT AND CEO, VANTAGESCORE SOLUTIONS, LLC

Mr. BURNS. Good afternoon. My name is Barrett Burns, and I am president and CEO of VantageScore Solutions. Thank you for the opportunity to testify at today's hearing.

VantageScore Solutions is a joint venture of the three credit bureaus: Equifax; Experian; and TransUnion. We were formed in 2006 to offer choice and competition in the credit score marketplace by providing a highly predictive credit score based on the latest analytic methodologies.

Each of the bureaus devoted their top scientists and analytic leaders to the development of our algorithm armed with a deep understanding of consumer risk modeling and the respective bureaus' database design. Team members spent several months building a new consumer credit score from the ground up.

Fifteen million anonymous consumer files served as the basis for development and testing of the new model. Innovative approaches in the model's development included advance segmentation techniques that provide more score cards than many traditional models, including segmentation cards for full file and thin file consumers.

Our algorithm rank orders consumers in the likelihood of becoming 90 days or more past due on a credit obligation based on many consumer behaviors and factors grouped into the following six buckets, which approximate these weightings: payment history, 32 percent; utilization, 23 percent; current balances, 15 percent; debt to credit, 13 percent; recent credit, 10 percent; and, available credit, 7 percent.

Additionally, medical debt when identified as a medical debt on a credit file, is excluded from the algorithm. The VantageScore scale ranges from 501 to 999. The higher a consumer's score, the less probability or likelihood of becoming 90 days or more past due.

The score range approximates the academic ratings scale familiar to most consumers, so in addition to receiving their numerical score, consumers also get the letter grade that corresponds with the three digit score. For example, a score between 900 and 999 is an "A"; between 800 and 899, "B;" and so forth.

VantageScore's algorithm is unique. We use a single algorithm across the three bureaus and we use a new modeling approach that looks differently and more deeply into consumer behaviors allowing us to score many individuals who would otherwise not be able to obtain a score.

VantageScore identifies three categories of consumers who face difficulties obtaining mainstream credit because they are unable to obtain a score. First, thin file consumers who have fewer than three accounts on their credit file. Between 35 and 50 million adults in the United States, or about 18 to 25 percent of the adult population, may be considered thin file and, therefore, are often underserved.

Second, infrequent credit users who may not be eligible for a score because there has not been any new activity on a credit account for 6 months. And third, new entrants who are just establishing credit relationships and have not had credit open for more than the 6 months required by some traditional scoring models.

VantageScore scores new entrants and reaches back deeper into an infrequent credit user's history, assisting millions more to obtain sustainable credit.

A comparison of VantageScore with a traditional CRC scoring model that used a random sample of mortgage customers saw an overall increase in scored consumers with VantageScore of 8 percent, or approximately 10 million consumers.

Additionally, 2.5 million consumers from the study were more accurately identified as higher credit quality than subprime.

We would like to commend Congressman Green for authoring the provision under the Housing and Economic Recovery Act of 2008 directing the Department of Housing and Urban Development to undertake a pilot program establishing an automated process to determine the creditworthiness of borrowers with insufficient credit histories.

Credit scores offer a uniform nonjudgmental mechanism that can be quickly deployed systemwide within an institution to respond to changing credit conditions. Although we believe that credit scores should be part of any decision process for credit approval, they should not be the sole criterion.

Approving large loans without also verifying other critical information needed to assess a consumer's ability to repay the loan is simply not prudent.

Risk has increased across all areas of the credit spectrum. VantageScore performs an annual re-validation to test the continued performance of our model. Our most recent re-validation demonstrates that VantageScore continues to rank order effectively and is capturing the increased risk present in this environment.

This allows lenders to understand the change in risk present to their portfolios from systemic shifts and adjust their business strategies to reflect that change.

Even though the performance of our scoring remains highly predictive under these stressful economic conditions, the conditions may require a shift in lender standards.

Thank you for the opportunity to contribute to this important discussion. I hope the information I have shared is beneficial to the subcommittee, and I would be pleased to answer any questions you might have, and to work with the members on scoring issues in the future.

[The prepared statement of Mr. Burns can be found on page 71 of the appendix.]

Chairman GUTIERREZ. Thank you so much.

Last, we have Ms. Anne P. Fortney, partner at Hudson Cook. You are recognized for 5 minutes.

STATEMENT OF ANNE P. FORTNEY, PARTNER, HUDSON COOK, LLP

Ms. FORTNEY. Thank you. Good afternoon. I am Anne Fortney, a partner in the Washington, D.C., office of the Hudson Cook law firm.

I appreciate the opportunity to appear before you today. I have almost 35 years experience in the consumer financial services field, including service as Associate Director for Credit Practices at the Federal Trade Commission. I have also worked as in-house counsel at a consumer credit card issuer.

Currently, in addition to counseling clients, I sometimes serve as a consultant and expert witness in litigation.

My experience in credit scoring is described in my written statement. Based on my experience, I believe that credit scoring is a very effective tool that ensures objective credit underwriting decisions.

Credit scoring systems eliminate the potential biases, illegal or even benign, that may exist in judgmental credit underwriting systems. They ensure that each consumer will be evaluated only according to attributes that are facially neutral and they facilitate fair lending compliance.

Ironically, it is the fact that credit scoring focuses only on objective factors that has engendered criticism. For example, some complained that credit scores may reflect circumstances beyond a consumer's control, such as a natural disaster. These kinds of events, however, are not dissimilar to other uncontrolled events that historically have been associated with payment default, such as job loss or illness.

Regardless of a consumer's personal control over events leading to default, credit underwriting systems necessarily focus on default when that is the risk they evaluate.

If characteristics such as payment histories or credit limits in credit scoring models were eliminated or restricted, regardless of their predictive value, the models would necessarily be less predictive. Less predictive credit scoring models would impair creditors' ability to make sound underwriting credit decisions or to price according to risk.

The inevitable result would be less credit availability at higher prices or at prices where good credit risk subsidizes the higher credit risk, and none of those results would be more fair than the present systems.

It is neither efficient nor fair to focus on individual circumstances in an underwriting system that is designed to predict risk for an entire population.

Some have complained that credit scoring models may penalize consumers who are conservative in their use of credit or who because of age or other circumstances may have limited credit histories.

If this allegation is true, the obvious solution is to increase the amount of information available for credit score developers. Without credit histories and similar empirical information, creditors are unable to assess the relative risk of a consumer's default.

By analogy, a 16-year-old has a perfect driving record when she obtains her first driver's permit. Despite the demonstrated value of

credit scoring, there continue to be anecdotal reports regarding its accuracy.

I believe these reports are based on a misunderstanding of how credit scoring works. They also overlook the fact that credit score users have a vested interest in making these models work.

Credit scoring models are continually re-evaluated and updated. Credit score developers and users of credit scores are in the best position to evaluate the accuracy and predictability of credit scores because of their impact on the bottom line.

Credit scoring has also been criticized for an adverse impact on minorities and other protected groups. However, studies by the Federal Reserve Board and the Federal Trade Commission found these systems are not proxies for prohibitive factors.

Characteristics that correlate to lower credit scores may also correlate to race, ethnicity, and other protected characteristics. This phenomenon is reflected in credit underwriting in general. The solution is to increase educational and employment opportunities and outreach for underserved populations, and to provide for alternative sources of data that may predict creditworthiness, such as rent, utility, and telecom payments.

I believe many concerns about credit scoring can be attributed to a lack of understanding about the factors applied in credit scoring. These concerns can be addressed through the implementation of new notices such as the risk-based pricing notice, and also increased education and awareness of the process.

Based on my experience at the FTC, I firmly believe that consumer education plays a large role in consumers' ability to protect themselves and secure their financial futures.

At the same time, I do not believe any providers of credit scores should be required to give away their product for free. Proponents of this view share a fundamental misunderstanding with those who criticize the educational credit scores available on various Web sites.

They persist in the mistaken belief that there is only one credit score and only one provider of that score. In fact, there are many credit scores provided by many different sources.

Moreover, it would be fundamentally unfair to require any credit score provider to give away its product. This is especially true because the educational materials available through the FTC and online provide adequate instruction for consumers.

Thank you for the opportunity to testify. I would be glad to answer your questions.

[The prepared statement of Ms. Fortney can be found on page 101 of the appendix.]

Chairman GUTIERREZ. Thank you so much for your testimony.

One of the most notorious examples of misleading advertisement are the ads of freecreditreport.com, run by Experian. This site does not provide free credit reports. The FTC has taken a number of steps to address this, and will testify about those actions in the second panel.

I wanted to show an ad that the FTC produced in its attempt to counteract misleading ads and educate consumers about their right to a truly free credit report through the official Web site,

annualcreditreport.com, where people should go get it free. I went there and it was free. It did not cost me anything.

The FTC does not have the budget to run this ad on TV, but let's show the FTC ad.

[Playing of advertisement.]

Chairman GUTIERREZ. That is actually a free credit report that you can get.

I just have to say for the record, I really did enjoy the commercials. They were very well produced. It kind of reminds me—I always seem to get the secondhand stuff. I did not have the cool phone, the cool car. I will not talk about not getting the date I wanted to get because ultimately I got her.

I really liked the commercials. I thought they were well produced, but the fact is, think about it. The FTC took the time to produce this commercial. I know there are those who have stated we are trying to muzzle Corporate America, their free speech. They have all the money in the world to run those deceptive ads.

It shows you what we need to do. When was the last time you saw the government actually produce an ad to counteract an ad that was put out there by Corporate America?

They do not have the money to run the ad, so I thought we should put that up just to start our conversation here today, and those cute little ads that are run by Experian. The FTC said they are so faulty, they even ran a parity on their own commercial.

Let me start by asking some questions. I want to ask Mr. Evan Hendricks, in your testimony, you sounded an alarm on the "shadowy operations of a little known database of customers called the National Consumer Telecom and Utilities Exchange," run with the help of Equifax, used by several major utilities and telecom companies to secretly screen prospective consumer applications in order to reject applications or charge higher deposits on non-paying customers.

In essence, your description of this practice makes it sound like almost a "Blackwater" of credit reporting, a secretive company that works hard to maintain its secrecy and may under cover be evading the application of relevant laws that affects many unsuspecting people who do not know of its existence.

Do consumers know the negative repercussions that they face when their late payments are sent to the agency and do they have a way to appeal the negative information in their files?

Mr. HENDRICKS. When I first did the story in October, I could not get any of those questions answered. I also wanted to know what utilities were members so we could maybe check up and see what was happening.

Since that story has run, I was pointed to their Web site this morning to show that they now have some contact information for consumers to order their reports from the database, and their communication said they are subject to the Fair Credit Reporting Act.

Again, they did not tell me that when I first asked them in October.

Chairman GUTIERREZ. Do they report all the information or just negative information?

Mr. HENDRICKS. We think it is mainly negative but we do not know because we do not have any power to audit and really find out what they do.

Clearly, it is a situation where consumers can get denied or charged a higher deposit for the utilities—

Chairman GUTIERREZ. Let me just ask you something. Let's say there was negative information and I was charged a higher rate for my utilities or a higher deposit, do I get a note in the mail? Let's say I was denied a credit card or a mortgage. I get something that says here is what information was used to deny this creditworthiness.

Do we get that when this happens?

Mr. HENDRICKS. Under the law, you are supposed to get it, but they would not answer whether it was given to consumers, so I am concerned it is not.

Chairman GUTIERREZ. We have a representative here, so maybe we will be able to get an answer from them today.

Mr. HENDRICKS. This is why sunshine is the best disinfectant.

Chairman GUTIERREZ. I agree. My time has expired. I have about 5 seconds. Let's see if Mr. Hensarling can get his 5 minutes in. We will be having a vote pretty soon.

Mr. Hensarling, you are recognized for 5 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman. It was a cute ad. I frankly do not know the facts dealing with freecreditreport.com. My understanding is certainly the Federal Trade Commission has the opportunity to issue cease and desist orders. I do not know if they have. I do not know if the facts are still being adjudicated or not.

I know, Mr. Chairman, you said unfortunately, the FTC did not have sufficient funds to run the ad. Perhaps had the House not passed on Sunday evening the $2.3 trillion takeover of our health care system bill and instead replaced it with something that would make health care affordable and maintain the high quality, maybe there would have been a few extra dollars to run that ad, but unfortunately, the President signed the legislation, so there goes the cute ad.

There are a lot of different—we continue to study all the different "but for" causes of the economic turmoil that we have in our economy today. Most people would point to the fact of all the no doc/low doc loans that took place in the residential mortgage market. If not the contributing factor, it is certainly one of the most significant contributing factors.

I am just curious about a parallel here. Again, I seem to see the prevailing winds from Congress trying to make credit files more thin but somehow let lenders have less information.

When I see that applied to residential real estate, what I see is great economic turmoil and human misery. It seems to me if anything, we would want to be pushing in the opposite direction of having more information about credit decisions as opposed to less.

Perhaps, I guess, it is the next panel who might have our professional economists, but if anybody cares to jump in on that one, I would be glad to hear an opinion on the matter.

Mr. Pratt, you seem to be the first one reaching for the button.

Mr. PRATT. There are two things we should think about when we think about the kind of risk data, a credit report is not just a point in time story of what I did most recently. I think one of the reasons we feel so strongly about preserving the entirety of the credit report history is that it sets into context both the good that we have done and also maybe the difficult experiences we have had at any given time.

Lenders want to do with business with consumers. Lenders want a complete picture of the possible risk. Lenders do not like saying no. Lenders will look, I suspect, even in this period of our recession, even at the struggles that many consumers have had, and they are going to see that in the context of a credit report where you may have a consumer who historically has done exceptionally well. That is the key to the credit report.

The credit report is not just a snapshot of some immediate missed payment, but it is about what happened over my lifetime of managing credit.

With regard to negative information, negative information does come off the file off a period of time. It is also important to know that lenders look at negative information differently over time. An immediate incident is probably considered to be more risky for a lender, but a lender who has—if you are looking at a 6-year-old event, it is not the same. A lender wants to do business with you.

That is really important in terms of context.

Mr. HENSARLING. Mr. Pratt, along the same line of questioning, one of the most common phrases we heard applied to what was going on in the residential real estate market was "predatory lending." I, myself, have concluded, yes, there was a lot of predatory lending going on. I have also concluded there was also a lot of predatory borrowing going on.

Again, predatory lending to some extent, lending money to people who cannot afford to pay it back, if we have congressionally mandated thinner credit files, is there going to be a greater probability of loaning money to people who cannot afford to pay it back? Yes or no?

Mr. PRATT. Our view is you have to have all the data on the table in order to ensure safe and sound lending decisions, and also fair lending decisions.

Again, for all of us who know we are just emerging, just struggling to get out of a deep, deep recession, we know there are going to be some consumers who will have a credit report that is not as perfect as it once was, but it is a history, Mr. Hensarling.

Mr. HENSARLING. Mr. Pratt, I see my time is starting to run out. You used the term "fairness." I want to go to you, Ms. Fortney. I think you said that the credit scoring models we have today "help eliminate bias," and I may be paraphrasing, that the on the spot individual judgment would otherwise interject that bias into the system.

Could you elaborate a little bit on what you mean by that?

Ms. FORTNEY. Yes.

Mr. HENSARLING. Apparently, no.

Chairman GUTIERREZ. I have already been accused of shutting down Corporate America's freedom of speech. I would never allow the one minority witness we have here—please give your answer.

Mr. HENSARLING. Thank you, Mr. Chairman. You listen well.

Ms. FORTNEY. I appreciate the opportunity. There are two aspects of this. As I said, I have been practicing for many years and I saw what the world was like before credit scoring. It was not as efficient and there were even benign biases that made the system less efficient when you had credit managers trying to draw on their imperfect memories and also the comparisons of how this applicant compared to others.

The other thing I know from my time at the Federal Trade Commission is that credit scoring has really facilitated law enforcement and compliance. If you look at the cases that have been brought by the Federal Trade Commission and by the Civil Rights Division of the Justice Department in the last 30 years, they have not involved credit scoring.

They have involved situations of what is called "discretionary pricing," by and large.

Chairman GUTIERREZ. Thank you, Ms. Fortney.

We just got a bell. We have 10 minutes. Maybe we will take questions on each side and then we will recess.

Mr. Moore is recognized for 5 minutes.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman. Some have proposed mandating a free credit score be given to consumers every year. As an alternative, I would look at something we did in drafting the FACT Act a few years ago.

That law requires under certain circumstances a credit score used by a lender for a loan application be provided directly to the applicant.

Instead of a mandatory free annual credit score, what if we required credit scores to be provided to the borrower and every application where a credit score is used?

The credit bureau already provides the information, so I do not believe it would be an additional burden on them. The information is specifically derived from the borrower's credit history, so they should have a right to see it regardless of whether their application is approved or not.

It could also help protect against lenders unfairly discriminating against loan applicants and empower consumers to better monitor their credit score and credit history.

Any reaction? Mr. Pratt, do you have any reaction?

Mr. PRATT. My first reaction is the same fact that did just this year bring to the Floor a new notice that I think many lenders will be delivering, in order words, the risk-based pricing notice. One of the options for complying with the risk-based pricing notice rule is for a lender to deliver to the consumer a credit score disclosure with every application that is made.

I think it is very likely by the end of this year, you will see an enormous increase in the number of score disclosures where you actually see a nexus between the lender who is using the score and the consumer who made the application.

We are going to see how consumers react to that. We are going to see what consumers learn from that. I really think that is the next step in this evolution of connecting consumers with scores and with data.

Mr. MOORE OF KANSAS. Very good. Mr. Burns, any comments, sir?

Mr. BURNS. I have nothing to add. Thank you.

Mr. MOORE OF KANSAS. Do any other panel members wish to add to that or respond? Yes, sir? Mr. Hendricks?

Mr. HENDRICKS. Thank you, Congressman Moore. I think it would still advance the educational purpose of the Fair Credit Reporting Act if we put in a free score requirement, and also make sure it is a score that is used by lenders. That would help people tie the information in their credit report to what does it mean in terms of the credit score.

There was one credit card company, Providian, that opened a service for its card members, and this was a nice market response, I thought, because they are buying the credit score, a true credit score every month to evaluate their credit cardholders.

What they did is they made it so their customers could access the credit score they were buying, and that was an alternative that made it so you could actually get access to a free real credit score.

Mr. MOORE OF KANSAS. Very good. Last question, in our modern society with our use of the Internet and online banking and shopping, one unfortunate reality is the increase in identity theft and how it can harm a responsible consumer's credit score.

As it relates to credit scores being damaged by those who steal another's identity and credit information, where do things stand now on identity theft and what steps can our government take to ensure that those who are victims of identity theft have their credit scores and credit history repaired quickly?

Do any of you have comments on that? Mr. Pratt?

Mr. PRATT. I think a couple of things in the FACT Act have been effective. For example, the FACT Act empowered all of us as consumers to obtain an identity theft report and in doing that, I can go to my lender and I can ask them to stop reporting data. I can go to my lender and I can get access to original application data in order to be more proactive in investigating a crime against me, myself. I can go to the credit bureau and ask them to remove data that was a result of the fraud.

I think the remedial powers that I have under the FCRA were great ideas then. They are good ideas now. I think they are workable in the marketplace.

If there is one challenge, it continues to be obtaining an identity theft report in order to do those things and some law enforcement agencies may or may not be able to give access to one.

Mr. MOORE OF KANSAS. Very good. Mr. Hendricks, do you have a comment, sir?

Mr. HENDRICKS. The FACT Act had great advances for consumer protection. I like the idea of having consumers plugged into their own information. One of the things that makes that possible is the monitoring services that all of these companies offer.

In the old days before we allowed for a free credit report, the Federal law capped the price of the credit report at $8. I am in favor of exploring the idea of capping the price of credit monitoring to encourage more people to take advantage of it. I think it would be a win-win situation because you will get more volume of people

using it when you lower the price and it will bring more people plugged into their own reports.

Mr. MOORE OF KANSAS. Thank you, Mr. Hendricks.

Mr. Chairman, I yield back to you the balance of my time.

Chairman GUTIERREZ. Thank you so much. I try not to be thin skinned here. I just feel personally kind of attacked, that I would be accused of shutting down free speech—it is a constitutional thing, you know, the basis of our democracy—of Corporate America.

I just wanted to let everyone know, we in the Majority set up these hearings. We invite the witnesses. We did have Mr. Hendricks here for the consumers. Representing Corporate America is seven. Come on. Cut the Democrats a break here. That is seven corporate America representatives.

Mr. HENDRICKS. Plus, I am an S-corporation, too.

Chairman GUTIERREZ. With that, we are going to get Mr. Marchant in for his 5 minutes, and then we are going to recess after Mr. Marchant's 5 minutes. Mr. Marchant, you are recognized for 5 minutes.

Mr. MARCHANT. Thank you, Mr. Chairman. I would like to explore some of the methods that some institutions use as far as coming up with approval ratings. For instance, FHA, and I do not know if it is a written policy, but there is a policy that says they are to disregard medical information in some of their approval processes, yet when you get a score, then the score reflects any past due medical bills.

Are there customers who have such a relationship with a credit score company or a credit reporting company where they could say to them, I would like to have the credit score of this person if you do not take a certain debt into consideration?

Are any of the programs that customized where a customer could find that information out or are the reports and the scores just given across-the-board?

Mr. WIERMANSKI. At TransUnion, we do not include medical debt in the calculation of the score. That is in the current versions of our generic products. When developing customized solutions, as you are describing, it is up to the customer, where they may want certain data elements excluded from a model development process.

In those situations, the information would be excluded and the model would be engineered without that data made available to it.

Mr. MARCHANT. Each customer can decide. I guess you would have to be a very large customer?

Mr. WIERMANSKI. Not necessarily. We service customers from several hundred member credit unions to the very large lenders. That is where I would say the art of developing credit scores come in. It is both an art and a science.

It is up to the outcome that we are trying to model and the business objectives of that institution, that when we create the credit characteristics that feed into the modeling process, that we take those types of things into consideration.

Mr. MARCHANT. Mr. Hendricks?

Mr. HENDRICKS. Thank you. These gentlemen will correct me if I am wrong, but I think the most widely used credit scores are the

FICO models from the 1990's. They do allow a medical collection to really damage your score.

You did not know about the co-pay and it comes as a $48 collection on your credit score. If it is something that just happened in the most recent months, it can drag down a score dramatically and really send you tail spinning to not be eligible for the credit.

It is a big problem now. My understanding also is that the modern version of FICO, FICO 8, excludes medical debts under $100. I think Mr. Burns talked about trying to exclude medical debts in the VantageScore as well.

Medical debt is a big problem and unfairly hurts consumers. I recommended if Fannie would move toward models like FICO 8 as a standard, that would help address this problem without even passing legislation.

Mr. MARCHANT. One of the concerns that I have had for the last 2 years is that it appears that since we are going to have a record number of foreclosures in the United States in history, and certainly a record number of late payments, and where we have numerous government programs that I fear lead people to believe that it is okay to be late, later, and latest on your payments, that we are creating an entire generation of subprime borrowers that we will experience problems with for the next 20 years.

I think many businesses are struggling with how to properly rate their scores and their credit reports.

I think in the future, you may have lenders and people who are wanting to extend credit who will say, we want to exclude a late payment, 60 days or less, and really customize it.

To me, this is one of the big looming problems we have in the recovery and in our economy coming back. That is a commentary. Yes, sir?

Mr. BURNS. If I may, I think you make a great point, and that is the difference between a credit score and credit criteria.

The credit score needs to be very objective. However, the credit criteria of a lender can decide what to exclude, for example, in their underwriting criteria.

Chairman GUTIERREZ. The time of the gentleman has expired. We are going to recess for about 45 minutes. We have a series of votes. I have been informed that is about how long it is going to take.

We are going to reconvene and finish with this panel. We are going to allow the other members who are here to ask you questions in 45 minutes.

We thank you for your testimony thus far. We ask you to stick around. We have some more questions for you, and then we will go to the second panel.

Thank you so much. The meeting is in recess until we get back, around 4:00. Thank you.

[recess]

Chairman GUTIERREZ. The subcommittee will come to order. Mr. Sherman, you are recognized for 5 minutes.

Mr. SHERMAN. Thank you, Mr. Chairman.

Is it free if you have to pay money for it? You are dealing with financial issues all the time. Is $14.95 free?

Mr. OLIAI. It does not sound free to me, but I personally do not pay for it.

Mr. SHERMAN. Mr. Hendricks, has the FTC adequately cleaned up the freecreditreport.com ad by saying well, you can keep the commercial and just put something illegible down at the bottom that tells the people it is not free?

Mr. HENDRICKS. No. I would like to see use of the word "free." I like plain language. I would like "free" to truly mean "free." The FTC has tightened up the rules on the ad, and Congress passed protections recently which is also going to help us in this kind of nonsense.

It has been very confusing for consumers. I am hoping those days are behind us.

Mr. SHERMAN. Mr. Quinn, we all like our free credit reports once a year, but nobody seems to care very much about my credit report, they just care about my FICO score. Can I get a free FICO score once a year?

Mr. QUINN. Fair Issac does have programs that we are orchestrating with lenders. It is called Score View, where the lender who pulls the FICO score for use in account review decision processes can also disclose that score as a secondary use—

Mr. SHERMAN. "Can."

Mr. QUINN. To the consumer.

Mr. SHERMAN. What if I want to know my FICO score before I start applying for a loan so I know whether to apply for the good ones or the bad ones or even know whether to go shopping for a good house or a bad house? How do I get my free FICO score?

Mr. QUINN. Today, either it is through Score View or if you have applied for a mortgage, as part of the FACT Act.

Mr. SHERMAN. Let's say I want to know what my FICO score is before I apply for a loan. How much is it going to cost me to find out?

Mr. QUINN. It will cost $15.95.

Mr. SHERMAN. At least you do not have ads that say "freeFICOscore.com" and then charge me $15.95.

Mr. QUINN. No.

Mr. SHERMAN. I yield back.

Chairman GUTIERREZ. Mr. Paulsen of Minnesota, you are recognized for 5 minutes.

Mr. PAULSEN. Thank you, Mr. Chairman.

I have some concerns about what may happen. We may have gone over some of this in the testimony. What can happen if we should start preventing certain types of information being allowed as part of a credit score computation.

For example, if I have a score of 650, and then we pass legislation banning certain information from being used, this would arguably cause those people who had lower scores to now have a higher score, in essence.

That is the intent of some of the legislation that is out there, but my score still will remain at 650, and at the end of the day, what does that mean for me as an individual?

Will 650 no longer be as soon as it once was in the past? Does that mean it is going to be now harder for me to get credit?

Mr. Quinn, maybe you can comment on that, potentially.

Mr. QUINN. Sure. If information is required to be suppressed from the score calculation and it causes the score to be inflated artificially from what it would be if that information were considered, then a lender would look at the score in their decision process and say I am used to a 650 equating to potentially, let's say, a 2 percent bad rate.

If the score is now inflated, they will have to potentially change their cutoff to accommodate for the inflation of the score driven by the suppression of certain data elements coming into the score calculation.

Mr. PAULSEN. Along those same lines, what would be the impact on predictability of credit scores if Congress mandated that certain data elements or trade lines be enmassed?

Mr. QUINN. We would have to do analysis to understand what the exact impact is, depending on what information is being suppressed. What we have seen through our data analysis is that more information provides for a more robust score, and if you start to take information out of the availability to be included in the score, it will usually result in a lost of predictive power in the model.

Mr. PAULSEN. Can you talk just a little bit about the intellectual property that is embedded within a credit score?

Mr. QUINN. Sure. FICO scores have been around since 1989, so that is over 20 years, and through that 20-year time period, we have learned a lot about credit scoring and how to get the most out of the bureau data from a predictive perspective.

However, from our perspective, the fundamental factors that drive the score calculation are very transparent. It is consumers who pay their bills on time, who keep their debt levels reasonably low, who only seek credit when they need credit, they are generally going to result in a more favorable score.

The fundamental practices of good credit behavior are pretty transparent, but that has been enmassed through 20-plus years of model development experience.

Mr. BURNS. If I may add to that, our intellectual property also includes a technique that minimizes the inconsistency between the bureaus, because we only have one algorithm between the bureaus. That is another intellectual property differential in our model.

Mr. PAULSEN. Ms. Hart, do you have anything to add or follow up on?

Ms. HART. Sure. I guess I would like to say we also have about 20 years of looking at our data and building generic scores and working with customers to build custom models for their business purposes.

We like to feel we have done a great job of mining our data, identifying those characteristics that very specifically are predictive of risk in a particular customer application.

Just to add to what Tom Quinn said, the factors really that go into these credit scores are very transparent to consumers. They are very basic, I would say very easy to understand.

What we are all doing is tweaking a little bit the attributes, tweaking a little bit the weights that are applied to those attributes to help the models be more predictive for a particular business need.

Generally, it should just be very clear to consumers, that they understand their credit report and how they are managing their credit overall. It should be clear to them the things that generally make their scores higher or lower relative to other scores.

Mr. PAULSEN. Thank you, Mr. Chairman. I yield back.

Chairman GUTIERREZ. Mr. Perlmutter from Colorado, you are recognized for 5 minutes.

Mr. PERLMUTTER. Thank you, Mr. Chairman. I apologize, I have been bouncing back and forth among a number of different committees.

My question is, I do this thing called "Government at the Grocery." Every other Saturday, we set up a congressional office in a different grocery store in my district.

A week ago Saturday, a woman came up, said she had two credit cards, and of course, in the last 6 months, 8 months, I do not know if any of you have experienced it, but many Americans have experienced the credit card rates going up, even though they have been paying on time and all that sort of stuff.

They closed their credit cards. She closed the credit cards. Then they find out their credit score had dropped because they closed their credit cards because they did not want to pay higher rates. They were just done.

Somebody explain to me how that happens.

Mr. QUINN. Sure. When you say "they closed it," meaning the consumer?

Mr. PERLMUTTER. The consumer closed the credit cards because their rates had been jacked up.

Mr. QUINN. Okay. The way that can happen is in the credit scoring model, at least with FICO scores, we do not have any characteristics that are looking at just available credit in isolation. There would be no points lost because of that.

However, we do look at what is called the "utilization calculation," so using a hypothetical example, if a consumer had 2 credit cards and they had $10,000 available to them as credit and a $5,000 balance, the $5,000 divided by the $10,000 is a 50 percent utilization calculation.

The data shows that the consumers who have been carrying higher utilization patterns are higher risk.

If a consumer in your situation closed down one of those credit cards and now let's say that had a line of $5,000, their utilization now looks at $5,000 divided by $5,000, which makes it 100 percent. Then that ends up potentially costing them points on their credit score because of that action.

Mr. HENDRICKS. Also, there is a second category that gets dinged in. First of all, what Mr. Quinn is talking about is each credit score is scored one at a time, and then they are scored again collectively, but the other category is your length of credit history.

If you close a credit card, then you can lose credit for how long you have had that credit card, which is 15 percent of your score.

Mr. PERLMUTTER. These people had these credit cards a long time, so then they close them, all of a sudden, the length of time they had the credit card no longer goes to their benefit.

Did anybody, in your algorithms, in your computations, in your calculations, and I understand it is all proprietary and I do not

care about knowing the ins and outs—part of what we have been dealing with in this Congress are credit card practices that in many ways were very sharp practices.

Double-billing cycles, a whole variety of things, then we take steps to try to deal with that. People then face higher rates for whatever reason, some of the credit card companies did that, and then because they close and choose not to maintain that credit, then they lose points on their credit score, so if they want to go buy a house, they are going to pay that much more money in interest.

Did anybody take any of this into consideration?

Mr. BURNS. If I may offer an opinion, the value of giving somebody credit for having a long history of a credit card or a mortgage or an auto loan is it shows they behaved well over that long period of time.

Mr. PERLMUTTER. Right.

Mr. BURNS. The other side of that coin is if they close the account, they lose that history. Our advice is just do not use the credit card any more and do not close your oldest accounts, because you should be given credit for behaving well over those years.

Mr. HENDRICKS. The trouble is that sometimes it is very counterintuitive. It seems responsible to close a credit card that you are paying through the nose for, but from a credit scoring point of view, it can ding you. You have to know the inside baseball to really protect yourself. I think that puts quite a burden on consumers.

Mr. PERLMUTTER. Right. I found it sort of counterintuitive. You said all right, I have had my credit card, the 6 percent was wonderful, now it is 16 percent, I do not need it any more, I do not want it any more, I am done.

Then all of a sudden, you get hammered over on the house borrowing side of this thing because your credit score is less.

I would just ask all of you to take another look at that. I appreciate sort of the philosophy behind it, but there are more questions to be asked.

I do not know if it was you, Mr. Pratt, or it might have been Mr. Quinn, who said well, it is not just a snapshot. We are looking at the long run. All of a sudden, you are not looking at the long run. You are looking at the snapshot.

Mr. PRATT. It is a point-in-time snapshot of the history, but it is the history. It is not just the one.

Mr. PERLMUTTER. Unless you close the account.

Mr. PRATT. You make a good point about closed accounts and then the history is no longer there. The counterintuitive part is just like looking at a consumer who is 21 years old who enters the marketplace, has a credit card for a year and maybe another consumer has literally the same credit profile but has been in the market for 25 years.

You can make a better estimation of how I have done if I have been in the marketplace for 25 years. That is all.

Chairman GUTIERREZ. The gentleman's time has expired.

Mr. PRATT. It may be a little counterintuitive, but there is a logic to it in terms of how that works.

Mr. PERLMUTTER. I thank the chairman and the panel.

Chairman GUTIERREZ. Mr. Campbell, you are recognized for 5 minutes, sir.

Mr. CAMPBELL. Thank you, Mr. Chairman.

I have a couple of questions. The first one is, is there any difference between the scores that a lender is going to use to evaluate someone's credit and the score that is disclosed to a consumer whether they paid it or not?

I will direct the question first to Mr. Oliai, because you are from a constituent company. Welcome, I am glad to have you here. The question is for all of you actually.

Mr. OLIAI. I guess there are a couple of parts to that answer. There really is no one score that fits every bill. There are many scores, as you have heard in some of the testimony prior to now.

When we talk about educational scores, typically we talk about those scores that have a lot of packaged material around them that say what are those elements that most positively influence your score, what are those elements that most negatively detract from your score, and they are designed with the sole purpose of educating the consumer about credit management, and those elements on the credit report that most influence a score.

The educational score is much like scores that lenders use in underwriting. They move in the same direction. They are predictive of risk. They are based off the same credit bureau data.

It is just the audience and the intent of the score is different. It is not the score itself that makes the educational score special, per se, it is more all of the material that goes with it and all that education that goes with it to educate the consumers on those elements that most influence the score.

Mr. CAMPBELL. Let me understand. There are different—for just the lender, they can request a different score because they want to weight something differently?

Mr. OLIAI. Absolutely. There are a multitude of scores, both that we would call in our nomenclature "generic scores," that predict slightly different outcomes when we are looking at credit risk. Most lenders rely heavily on custom scores to make their underwriting decisions. Those scores that are custom to their prior lending experience.

Mr. CAMPBELL. What the consumer will get, which you call "educational," is basically a "generic score," but a lender, because maybe it is a long-term loan or short-term loan, whatever, may have their own custom thing that they are getting that could be different?

Mr. OLIAI. That is correct. A lender may use multiple scores for the same credit underwriting decision.

Mr. CAMPBELL. Thank you. Mr. Pratt and Mr. Hendricks are both chomping at the bit here. Go ahead, Mr. Pratt.

Mr. PRATT. It is really important—I think our world view is that every time a consumer acquires a score, they are obviously more than likely getting a credit report at the same time, and it is always educational, meaning because there is no one score, because a single lender could use different scores for different products, because a lender could take an external score and fold it into an internal underwriting decision, it is a mistaken assumption to think we are going to be able to get a consumer's knowledge to the point where they know exactly how bank number one is going to say yes

or no and at what price, and then similarly bank number two and bank number three.

That is what we worry about with some of these ideas where you get into there must be some score that is definitively the only one that is going to tell me the whole truth.

There are scores that tell me—I think Ms. Hart and others have referenced it—in fact, it has been in the testimonies of some of our score developers here at the table, what is important about my credit management.

Have I paid my bills on time? How much credit do I have outstanding? And so on. That is really the core of what we do when we get a score. We learn about how lenders look at us and how they analyze us and we learn a little bit about how to structure our financial management more effectively.

Mr. HENDRICKS. From a consumer's point of view, the FICO score, according to the numbers, is used by 75 percent of the lenders. When a consumer goes to MyFICO.com and buys the FICO score, you know that is a score that is used by lenders.

When you go to TransUnion and buy your true credit score, that is based on the TransUnion model. That is not used by lenders. If you go to Experian or freecreditreport.com and buy your score, that again is not used by lenders.

The VantageScore is used by lenders, but I am not sure we have good data yet on how far it has penetrated the market.

That is the kind of confusion. The problem is sometimes consumers will buy a knock-off score and think it is a real score and find out when they apply for a loan, they get a different score.

Mr. CAMPBELL. It sounds like—I did not know this and that is why I asked the question—if the scores are kind of customized by the lender for whatever, there is no "the" score. Is it not important that the consumer understand that, that even though your score is 600, you could be something else if a lender weights something differently?

Mr. HENDRICKS. Right. Anybody who sells the score should also tell the consumer is it used by lenders, any lenders, and is it used by a majority or some segment of lenders.

Mr. CAMPBELL. Thank you, Mr. Chairman.

Chairman GUTIERREZ. Mr. Green of Texas, you are recognized for 5 minutes, sir.

Mr. GREEN. Thank you, Mr. Chairman. I thank the witnesses for appearing. I am pleased that I got here to hear that exchange. There are many consumers who are confused and who are of the opinion that if I take advantage of this offer to get my credit score by way of some entity that is offering it to me, I will have the "the" credit score. What you are saying is it may be "a" credit score but not necessarily "the" credit score.

Is that a fair statement?

Mr. HENDRICKS. Yes.

Mr. GREEN. Does someone differ? By the way, this is not the line of questioning I intend to pursue, but I think it is worthy of consideration.

Mr. WIERMANSKI. First, I would like to correct a statement made by Mr. Hendricks. The scores that TransUnion makes available to consumers are used for hundreds of millions of credit decisions, so

they are not what people call a "FAKO score." They are production-ready, commercially-made-available scores. I wanted to clarify that.

There are many different scores that are made available to our customers that are used for decisioning purposes, and there is not one score that is used. At TransUnion, for instance, we have 12 different versions of a FICO score that is made available that are different algorithms used for different purposes.

There is not one FICO score. The only one score that I know of that exists out there is the one offered by VantageScore where it is the same algorithm across all three credit bureaus.

Mr. GREEN. Thank you very much. Thank you for that new term for my vocabulary. "FAKO." Is that what you said? "FAKO score?"

Mr. WIERMANSKI. That is a term that I picked up the last time I testified.

Mr. QUINN. If I may say something, I work for FICO, and of the top 100 lenders that use FICO scores in their decisioning, as Mr. Hendricks indicated, 75 percent of the credit decisions are made with FICO scores; it is the predominant score.

As Mr. Wiermanski indicated, there are multiple versions of FICO, but the design blueprint and the underlying data parameters that drive the score are the same, so from FICO's perspective, the consumer benefits most greatly from getting access to the score that lenders use, which in our position is FICO scores.

Mr. GREEN. Thank you. Is there a difference in opinion? Go right ahead, sir.

Mr. OLIAI. Thank you. When I hear the term "FAKO score," it is something that I find personally insulting and motivating at the same time. I have been in this business working with Experian since 1993 building these models.

We do have widespread usage across and good penetration across both custom and generic models, much like the other leading companies here on the panel.

I would contend there is no universal score. You heard Mr. Wiermanski talk about 12 different versions. There are at least eight at Experian, not to mention all the Experian-developed scores that we have done in a proprietary fashion over the years.

Mr. GREEN. All right. Thank you very much. Let me move onto another area. I appreciate your comments.

Alternative credit scoring, for those of you who do scores, can you give me some intelligence on how this will impact you? There is a possibility that HUD may introduce alternative credit scoring. There are people who can afford to pay for a given item but they do not have what we call "traditional credit." They pay light, gas, water, phone, but these things are not always scored. In fact, there is a good likelihood that they will not be scored.

How will alternative credit scoring impact you? Yes, sir.

Mr. BURNS. Those payments, if they are reported to the credit file, are picked up by VantageScore and that is one reason we can score millions more other people. It is recorded. It should be recorded. It is highly predictive. We do use that data in our model calculation.

Mr. GREEN. Mr. Pratt? Go right ahead, sir.

Mr. PRATT. Just to set up this circumstance, the real challenge we have with alternative data are laws and I guess lack of guidance as to whether or not this data can be used.

In other words, many consumers have a cellular phone and in fact, it may be the only phone they have. Telecom companies are not clear on whether or not they can report that data to a data exchange database or to a credit reporting database.

One of the great impediments that is impinging on the progress towards, I guess, a more fulsome look at a consumer who may otherwise have a somewhat thin file, is this inability in the data industry of us to be able to get that data into a database to do the full and complete analytics and to really deploy better analytical tools that include more consumers in the marketplace. That is our biggest challenge.

Mr. GREEN. Yes, sir. Mr. Quinn?

Mr. QUINN. Just so everybody knows, in 2004, Fair Issac developed and released a score called the "FICO expansion score." What this score does is it takes in alternative credit information that is not reported to the big three.

For example, both positive and negative information on how you manage your checking account, how you manage credit membership relationships, if utility information is provided and verified, the model will consider that as well.

We built that in response to lender questions about wanting to be able to more confidently extend credit to the underserved population, so this is an alternative they can use when there is not a traditional credit file on the consumer. They can come and get the FICO expansion score.

Mr. GREEN. Thank you, sir. My time has expired. Thank you, Mr. Chairman. You have been very generous.

Chairman GUTIERREZ. Mr. Royce of California, you are recognized for 5 minutes.

Mr. ROYCE. Thank you very much, Mr. Chairman. I was going to ask Mr. Pratt, as you know, this committee has marked up and the House has passed its consumer financial protection agency legislation. That is now in the Senate.

What would happen if this agency, armed with broad unchecked authority, began cracking down on what goes into a credit file? What would be the consequences of that?

Mr. PRATT. I suppose whether it is law or an agency that is involved in, as you say, the crackdown, the concern for us is first of all, there is no science necessarily behind the decisions that would be made. That would be one risk.

I really would turn to all these partners, all these competitors at the table, they are the brilliant folks who are going to help us make a better decision. If data should be in, they are going to tell us where it should be in, how it should be weighted, why it should be weighted. That is the beauty of this industry.

To make an arbitrary decision to exclude a set of data without understanding consequence is part of this story. The other part is the death by 1,000 cuts. You could run data. You could run a score and say what about this piece. If it is not in, how consequential is that.

My concern is the cumulative effect of removing progressively this piece and that piece and this piece, and you ultimately get to a point where you have harmed the system and you have a less effective system. That would be a shame.

We have the best credit reporting system in the world, bar none, period.

Mr. ROYCE. What would the result be? What would creditors do? Would they begin to question the integrity of an individual's credit file? What impact would that have on the general appetite for risk among those creditors out there, in your opinion?

Mr. PRATT. It is all suppositional. I am assuming that creditors would have wider bands for risk. They might not be able to allocate risk as effectively. They might not be able to allocate risk at all to certain segments, so you might have less credit in the marketplace. You might have more expensive credit for more consumers. That is inevitably the consequence of removing data from the credit bureau system.

Mr. ROYCE. Less extension of credit on the lower end of the credit spectrum probably, and when you cannot accurately price credit, the cost usually goes up for everybody.

Mr. PRATT. Yes, sir.

Mr. ROYCE. Let me ask a second question. Maybe I will ask this of Mr. Oliai. Can you explain how insurance companies use credit information to assist them in underwriting automobile and homeowners' insurance? What is the thumbnail sketch process there?

Mr. OLIAI. It is really not 100 percent my area of expertise, but in what involvement I have had with using credit information for insurance, the credit data is put into those scoring models with other information that the insurance companies have, and is deemed predictive of whatever negative outcome the insurance company is modeling, things like false claims, excessive claims, those sorts of things.

The role of the credit data, much like in financial services, is an input to an underwriting decision.

Mr. ROYCE. We have seen studies here and had testimony in the past that confirmed a very strong correlation between credit scores and risk. Is it fair to say that the use of credit-based insurance scores allows insurers then to more accurately price their policies for the risks they are covering?

Mr. OLIAI. I believe that to be a fair statement; yes.

Mr. ROYCE. On the same CFPA question, I was going to ask Ms. Fortney, you were at the FTC, what would you think if the CFPA got the authority over this credit scoring process? What would be your observations on that based on your experience?

Ms. FORTNEY. As Mr. Pratt said, I believe the difficulty would be if either by law or by regulation the government attempted to exclude certain characteristics that could be considered, the result would be a less predictive system, and that less predictive system would result in either fewer people getting credit or insurance or also paying higher prices.

Mr. ROYCE. Mr. Chairman, I want to thank the witnesses for coming out and testifying today. I appreciate it very much.

Chairman GUTIERREZ. I echo those sentiments. Congresswoman Jackie Speier of California, you are recognized for 5 minutes.

Ms. SPEIER. Thank you, Mr. Chairman. I really appreciate you holding this hearing today. This issue to me is one of the most important consumer protection issues that we could be addressing, and frankly, I do not think we are doing anything.

In fact, as I have listened to the testimony today, it reminds me a great deal of our discussion of credit rating agencies. The credit rating agencies came under a great deal of criticism this year because one, they have garbage in, so garbage came out. There was no due diligence required by any of the credit rating agencies when they rated these various instruments.

Two, they were responsive to the issuer, not to the consumer who was evaluating whether or not to purchase that particular instrument; and three, they were not subject to the full disclosure by the SEC.

I see similar things going on here. What I would like to focus on is the error rate that continues to exist in credit reports and the due diligence that none of you really do in order to respond to them.

A recent U.S. Public Interest Research Group and Consumers Union study found that errors in 25 percent of the credit reports are serious enough to cause a denial of credit. That is serious, when you are denied credit.

The FCRA has been around for 40 years, and for 40 years, the credit reporting agencies were required to do a level of re-investigation. I want to just read now from a report called "Automated Injustice."

Mr. Chairman, I would like this submitted for the record.

Chairman GUTIERREZ. Without objection, it is so ordered.

Ms. SPEIER. In this particular Consumer Law Center report, they speak to this whole issue of the re-investigation. The question was asked what goes on with these re-investigations. This was a deposition taken of the vice president of Equifax for global consumer services.

"Did your employee have telephones on their desks?"

"I do not believe so."

"As part of their compliance with Equifax's procedures, did the employee telephone the consumer as part of conducting a re-investigation?"

"They did not."

"Did they telephone creditors, the furnishers, as part of conducting the re-investigation?"

"They did not."

"Did they telephone anybody from outside DDC or Equifax as part of conducting the re-investigation?"

"They did not."

"What about e-mailing any of those?"

As you can see, they did not do anything. What they do, the only human contact in the re-investigation from what I understand is someone reviewing what the furnisher has provided and then giving a two or three digit code.

My question, first to all of the credit reporting agencies, is do you outsource this function to other countries?

Mr. PRATT. I am actually probably the only credit bureau person here at the table since these folks are all actually the heads of the

decision sciences' side of these businesses, so they do not actually deal with and manage the credit bureaus.

My response is this. First of all, I am going to push back on the study that you have quoted because it is not a statistically valid study. It does not study a sample that comes anywhere close to the size of a database which includes 200 million consumers.

The GAO looked at this and they came to that conclusion, so Congresswoman, it was not me who came to that conclusion. It was the Government Accountability Office that came to that conclusion, and we are grateful that they did. This was just a polling, and in some cases, just employees of a company.

That really is not indicative—

Ms. SPEIER. I guess my question is, and I would like to ask it of you again, do you outsource that function?

Mr. PRATT. I think our members make different decisions about where they locate their business.

Ms. SPEIER. It is a "yes" or "no" answer. Do you outsource?

Mr. PRATT. I do not think it is a "yes" or "no." I think it is more than that.

Ms. SPEIER. You either outsource or you do not outsource. Do you outsource?

Mr. PRATT. Outsource here in the United States?

Ms. SPEIER. No, outsource in other countries.

Mr. PRATT. I will tell you what, I will go back to our companies and see if we cannot get you a better answer.

Ms. SPEIER. Was I fairly accurate in terms of the way your credit reporting agency operates in terms of the re-investigation?

Mr. PRATT. No, actually, first of all, using a deposition as an indication of how a process works just does not work because a lawyer is trained to ask certain questions in a certain way in order to end up in an accusatory situation.

That is exactly what a deposition is, to try to pin you into a corner. No, I do not think that report reflects accurately at all—

Ms. SPEIER. Mr. Pratt, I asked you a simple question. What re-investigation procedure do you follow?

Mr. PRATT. All of our members follow the Fair Credit Reporting Act. All of our members provide consumers with toll-free access to live personnel after they have received their credit report. All of our members take full and complete information from consumers, and all of our members provide an accurate reflection of that dispute to the lender, and all of our members then ask lenders to re-investigate because they ultimately—

Ms. SPEIER. Actually, my time has expired.

Chairman GUTIERREZ. I do not want to be accused of stopping Corporate America from speaking, but the time has expired.

Mr. Ellison, you are recognized for 5 minutes.

Mr. ELLISON. Mr. Chairman, thank you for convening this hearing. Let me thank all of the members of the panel.

My first question is for Mr. Pratt. There is no "Spratt" on the panel, is there?

Mr. PRATT. No, that must be me.

Mr. ELLISON. On page 18 of your written testimony, you state, "Credit scores remove social bias and provide fair treatment for consumers." Do you recall that?

Mr. PRATT. Yes, sir.

Mr. ELLISON. This is somewhat puzzling to me because in Mr. Vladeck's written statement on behalf of the FTC, on page 14, he references a 2007 FTC study on automobile insurance, and I will quote from that study.

It says, "The FTC found that credit-based insurance scores are distributed differently among racial and ethnic groups and therefore likely have an effect on the insurance premiums that those groups pay, on average, with non-Hispanic White and Asian-American consumers paying less and African-American and Hispanic consumers paying more."

Can you offer any insight into why there might be a discrepancy between your observation and that of the FTC representative?

Mr. PRATT. Thank you for asking the question. It is important to get these points straight so that we have a good record for all of you as members who are ultimately going to have to think through these issues further.

Our point is that a credit score is blind. It does not know my race. It does not know my age. All it does is look at empirical data, data on a credit report, and ultimately, as Mr. Quinn's testimony indicated, a number is scored, a scoring system then generates a number.

Because of that, we remove the kind of lending biases that we saw in this country and that individuals experienced in this country at one time.

Scores, because they are blind to these triggers, these ECOA triggers, have removed the risks of those triggers, gender or race, for example, from being included somehow in the thinking of the lender who otherwise might say yes.

With regard to the study, the key is to make sure that a score accurately scores risk. It may be that certain communities have average lower scores than others but the key would be if I walk in, if two different people of two different races walk in—

Mr. ELLISON. Mr. Pratt, I appreciate your answer, and I do not want to suppress you in any way, but they only give me 5 minutes.

Mr. Quinn, if you would help me with this question. On page 9 of Mr. Hendricks' written testimony, he states, "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."

Do you agree with that statement, and if you do, can you explain the rationale for why there might be two different scores?

Mr. QUINN. Sure. If a consumer were to get their FICO today on MyFICO.com and then apply for a loan a month from now, that time period could cause new information to be reported on the credit report.

Mr. ELLISON. Excuse me, Mr. Quinn. Are you saying the scores are the same but they change over time quickly? Are you essentially refuting what he is saying by saying they are the same but time may cause scores to change?

Mr. QUINN. Right. The algorithm that calculates the score stays the same potentially but the information that gets fed into the model can change because new information is updated every second on the credit reporting databases, and that can cause the score to change if new information hits the file.

Mr. ELLISON. Mr. Hendricks, what do you say to that?

Mr. HENDRICKS. There are other differences that could be caused by, for example, the lenders using the FICO model for credit cards or for auto loans. There are some differences there that can cause those differences.

I just think between you and Congresswoman Speier and the members, you are asking really good questions. I think it points to the fact that we do not have great data to answer these questions, and to get the great data, we have to kind of look at our enforcement infrastructure.

I think what these credit bureaus do is so important that we should look at them more as public utilities in that kind of—

Mr. ELLISON. Let me ask you this question. What is the market share? Has there ever been a lawsuit? I understand there was an antitrust lawsuit. What was the outcome of that?

Do you foresee a level of market concentration such that the market is so concentrated by a few players, that even if they colluded in an undeliberate way, if you understand what I am trying to say, that we end up with sort of a group that ends up excluding people.

Do you have any views on this subject?

Mr. HENDRICKS. Yes. For the foreseeable future, what you see is what you get. We have the big three and they play an incredibly important role in people's lives.

Mr. ELLISON. Are the big three 100 percent?

Mr. HENDRICKS. Yes, they control—there are the three nationwide databases.

Mr. ELLISON. There was a lawsuit, an antitrust lawsuit. What happened with that?

Mr. HENDRICKS. As far as I know, it was dismissed.

Mr. QUINN. The lawsuit is still pending.

Mr. BURNS. If I could clarify that—

Mr. ELLISON. Unanimous consent for 30 seconds.

Chairman GUTIERREZ. An additional 15 seconds for the gentleman.

Mr. BURNS. If I can clarify that, the lawsuit went to trial and was dismissed at a trial and it is apparently under appeal now. The lawsuit was won by us.

Mr. ELLISON. I have many more questions. Thank you, gentlemen and ladies.

Chairman GUTIERREZ. Thank you. I ask unanimous consent that Ms. Kilroy of Ohio, a member of the full Financial Services Committee, be allowed to sit on this panel and ask questions for 5 minutes. Hearing no objection, it is so ordered.

The gentlelady is recognized for 5 minutes.

Ms. KILROY. Thank you very much, Mr. Chairman. I thank all the witnesses for their appearance here today.

Mr. Quinn, I understand that FICO is the most widely used system by credit reporting agencies; is that correct?

Mr. QUINN. We position it as the most widely-used credit score used by lenders.

Ms. KILROY. By lenders. To these lenders and any other entity that may use these credit scores, they are putting them to really important uses in the economy, both for the lender and for a con-

sumer who is attempting to obtain a loan to buy a car or to buy a house; is that correct?

Mr. QUINN. Yes. The lenders will use the score in addition to other information to determine if the consumer can be approved for credit and to set terms for that credit.

Ms. KILROY. Those terms can mean that one consumer with a certain score would pay over the course of a loan considerably less than another consumer might pay?

Mr. QUINN. Potentially; yes.

Ms. KILROY. It is a pretty heavy impact on the lives of individual consumers?

Mr. QUINN. Potentially; yes.

Ms. KILROY. For those scores to be useful for the lender to make the right decisions and to be fair to the consumers, since they have significant financial repercussions, it is important for those credit scores to be validly predictive of consumer behavior in terms of handling their finances; correct?

Mr. QUINN. Yes, the lenders only want to use credit scores that they feel comfortable to rank order risk and predict risk.

Ms. KILROY. Data that has not been proven to be predictive should not be included in the credit score?

Mr. QUINN. Data that has not been proven to be predictive should not be in the credit score. I would agree.

Ms. KILROY. What you want to do is predict how that person handles his or her finances, whether or not they can live within their means; correct?

Mr. QUINN. The model is designed to rank order risk so it is predicting their ability to handle future credit obligations.

Ms. KILROY. You might have heard a little bit maybe this week or even before this week that Americans around this country are having huge issues with health insurance, and in fact, 72 million Americans are affected by medical bill problems or accrued medical debt. Do you agree with that?

Mr. QUINN. I am not an expert in that area. I cannot comment "yes" or "no."

Ms. KILROY. When you are looking at credit scoring, would medical debt be one of the areas that is included in your credit scores?

Mr. QUINN. We do not consider any medical debt information in the score. We do consider medical collection information.

Ms. KILROY. A person who may have had a perfectly wonderful credit score but got hit by a bus or received a number of statements that say this is not a bill, and a confusing array of post-emergency room visits or have issues with their insurance company about paying those medical bills, that person with that good credit score could be hit with a collection issue with respect to medical debt; correct?

That medical debt would in one way or another end up adversely affecting their credit score.

Mr. QUINN. The medical collection item that gets reported to the bureau could impact their score; that is correct.

Ms. KILROY. If a person takes some time to do it, but actually pays or resolves that medical debt or medical collection issue, would you say that is predictive of how they handled their finances?

Mr. QUINN. What the data shows us when we analyze medical collection information is the fact that the medical collection item occurred is predictive of future risk, and that is why the model considers that information.

Ms. KILROY. If a person makes those efforts and pays off their medical debt, that derogatory information, if it had gone to collection, that stays on their credit record for years; isn't that correct?

Mr. QUINN. My understanding is that the collection information can stay on the credit report for up to 7 years.

Ms. KILROY. You would argue that someone who paid off their medical debt and resolved that issue has the same kind of predictive value as somebody who runs up their credit cards buying big screen TVs or stereos or other consumer goods?

Mr. QUINN. What the data shows us is that the presence of medical collection information on the consumer's report is predictive of future risk, but it is important to understand that the model is not looking just at that component, so it is looking at the overall picture of the consumer's credit report.

It is the total picture that is driving the score, not just one data element.

Ms. KILROY. Craig Watts is a spokesperson for your company; is that correct?

Mr. QUINN. Craig Watts works in our Public Relations Department; yes.

Ms. KILROY. Did he not make a statement that paid medical debt was not indicative of somebody's ability to pay, predictive of how they are going to handle their debt?

Mr. GREEN. [presiding] If I may, I am going to ask that you give your answer in writing. We have had a call for a vote. What we would like to do is dismiss this panel and try to get through the next so as not to have them come back and have us come back.

If you would, give your answer in writing. The time has expired. Thank you.

I would like to thank this panel. Of course, we may submit to you additional questions in writing. Members will have the opportunity to do so within the next 30 days.

Thank you very much. You are dismissed.

If I may, I will have quick introductions and we will move right to your statements. If you could summarize as best you can, it will help us and help you. We are trying not to hold you longer than we have to, which means you will not have to come back after a series of votes.

We have Ms. Sandra Braunstein, and she is the Director of Consumer and Community Affairs with the Federal Reserve Board of Directors.

Mr. David Vladeck. Mr. Vladeck is the Bureau of Consumer Protection Director, Federal Trade Commission.

We thank both of you and we will move immediately to Ms. Braunstein for your statement, and if you can summarize, it would be helpful.

STATEMENT OF SANDRA F. BRAUNSTEIN, DIRECTOR, DIVISION OF CONSUMER AND COMMUNITY AFFAIRS, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Ms. BRAUNSTEIN. Good afternoon, Mr. Chairman, Ranking Member Hensarling, and members of the subcommittee. Thank you for this opportunity to address the role of the Federal Reserve Board in ensuring that lenders use credit scoring systems appropriately to evaluate consumers' credit risks.

The three roles that the Board plays in this regard are as a rule writer, a supervisor, and a research institution.

As a rule writer, the Board has sole rule writing authority for Regulation B, which implements the Equal Credit Opportunity Act or ECOA. The Board has shared rulemaking authority with other regulatory agencies under the Fair and Accurate Credit Transactions Act of 2003, the FACT Act.

In January, the Board and the FTC issued final rules to implement the risk-based pricing provisions of the FACT Act. Creditors that engage in risk-based pricing generally offer more favorable terms to consumers with good credit histories and less favorable terms to consumers with imperfect credit histories.

The risk-based pricing provisions give consumers who were granted credit on less favorable terms protections similar to those afforded to consumers who are denied credit. Denied consumers receive an adverse action notice.

Under the new rules, a creditor who uses credit reports can provide a risk-based pricing notice to those consumers who receive credit on terms that are not as favorable as the terms the creditor has provided to other customers.

Those consumers can contact the credit bureau to obtain a free copy of their credit report.

As an alternative, creditors can provide a credit score disclosure instead of a risk-based pricing notice. Under the credit score disclosure alternative, consumers who apply for credit automatically receive a free credit score and information about their score in the notice.

I expect that many creditors will use the credit score alternative, which will give consumers access to their credit scores without charge.

As a supervisor of financial institutions, the Board conducts fair lending examinations to ensure that financial institutions are using credit score models that comply with ECOA.

ECOA generally prohibits creditors from discriminating against an applicant in a credit transaction on the basis of race, national origin, age, marital status or sex. Examiners ensure the prohibited bases are not used in a credit scoring system. Examiners also ensure the creditors are not using credit scoring systems in a way that has a disparate impact on protected groups.

Properly constructed credit scoring systems may help lenders facilitate consistency and limit lender discretion in the credit evaluation process which promotes fair lending.

As a research institution, the Federal Reserve studies significant trends in credit markets, publishes their research, and encourages research by other parties.

As directed by Congress, the Board prepared a report on 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.

The Board's report is the first comprehensive study of its kind. It describes original research conducted by Board staff. For this research, Board staff developed a unique database that links credit records and personal demographic information.

The findings of the Board's report are significant. Major findings include one, credit scoring has increased the availability and affordability of credit. Credit scoring has increased the consistency and objectivity of credit evaluations, and has reduced some of the discretion that could lead to discrimination.

Two, different populations on average have substantially different scores based on differences in their credit histories.

Three, for every population group considered, credit scores consistently predict the credit risk of individuals. Thus, regardless of race, ethnicity, sex or age, persons with higher or better credit scores consistently performed better than persons with lower scores.

The study found that for all population groups, interest rates and average estimated denial rates consistently declined as credit scores increased.

I will be happy to answer any questions.

[The prepared statement of Ms. Braunstein can be found on page 51 of the appendix.]

Mr. GREEN. Thank you very much.

We will now move to Mr. Vladeck for his 5 minutes, and if you can be a little bit briefer than 5 minutes, it would be appreciated.

STATEMENT OF DAVID VLADECK, DIRECTOR, BUREAU OF CONSUMER PROTECTION, FEDERAL TRADE COMMISSION

Mr. VLADECK. I will try.

Mr. Chairman, Ranking Member Hensarling, members of the subcommittee, my name is David Vladeck. I am the Director of the Bureau of Consumer Protection at the Federal Trade Commission.

The views expressed in our written testimony were approved by the Commission. The views that I may state here, those are my own and should not be ascribed to either the Commission or any member.

I will leave to you our written testimony which describes in detail the 30 FACT Act projects that the Commission has completed, including rulemakings, studies, and educational campaigns.

I would like to take a few minutes just to highlight our responses to some of the issues raised in our invitation letter.

First, in addition to the 2007 study that we did on the use of credit scores and credit-based insurance scores in the automobile market, we are currently working on a follow-up report analyzing the effects of credit-based insurance scores used for homeowners' insurance. The report will use extensive insurance policy data collected through the use of compulsory process from the nine largest insurance firms.

Second, we have talked a lot today about the issue of accuracy of credit reports. Ensuring the accuracy of credit reports is crucial for consumers for reasons that go to their very livelihood.

If information in their credit report is inaccurate, consumers could suffer devastating economic consequences. They could be wrongfully denied credit, insurance, housing or employment.

We are trying to improve the accuracy of consumer reports in several ways. First, we have recently issued amendments to the free credit report rule to address deceptive advertising in the advertising of free credit reports. With the new disclosures we are requiring, we believe we have strengthened the ability of consumers to obtain no-strings-attached, free credit reports.

Additionally, we have worked with other agencies, including the Federal Reserve, to issue the furnisher rules, which call on furnishers to improve the accuracy of information they provide to the credit reporting agencies and give consumers the right to dispute errors in their reports directly with the furnishers of the information as well as to making disputes with the consumer reporting agencies.

Finally, let me turn to the transparency issue that we have talked about already. Credit scores are used widely by creditors. They affect whether a consumer can obtain a loan and how much the consumer will have to pay for it.

We have long been advocates for access to credit scores and information about what those scores mean, and how they are using them.

The FACT Act gave consumers the right to purchase a credit score from credit reporting agencies and required certain mortgage lenders to provide free credit scores to home loan applicants.

As a result, consumers have had better access to credit scores over the last couple of years, but we have taken additional steps to improve that.

As I mentioned, the FTC along with the Federal Reserve Board issued its risk-based pricing rule, which requires certain companies to provide consumers with notice when their report information has been used to provide them less favorable loan terms than other consumers, but the rule also gives companies the option to provide all of their customers with a free credit score along with information about that score.

We are hoping that companies will take this option to provide consumers at no charge to the consumer their credit scores.

We have also engaged in research and a great deal of public education on the issue of credit scores.

We look forward to working with this subcommittee on these and other consumer protection issues. We will be glad to answer any questions you might have in writing. I understand the time pressures.

[The prepared statement of Mr. Vladeck can be found on page 176 of the appendix.]

Mr. GREEN. Thank you very much for your understanding. I am going to ask my questions in writing. The ranking member has concurred.

If the members who are here, Ms. Speier, if you can ask one question, perhaps we can get one answer to that one question, and

Ms. Kilroy, we will extend to you a similar courtesy, if the question can be as terse as possible, please.

Ms. SPEIER. Thank you, Mr. Chairman. To you, Mr. Vladeck, I do not think there is any teeth in the re-investigation requirements under the FACT Act or the original Act. Do you concur in that and if you do, what should we do to make sure re-investigation does take place?

Mr. VLADECK. I think there are two answers, and I will try to be as brief as I can. I would like to amplify this answer in writing, if I may.

First, the furnisher rule takes effect in July. We think this is going to have a substantial impact on the ability of consumers to dispute information in their credit files and get an answer. That, coupled with the accuracy parts and the dispute parts of the rules, we think, will go some way to do it.

I would also say we are doing this through our enforcement. We are now requiring collection agencies, when there are disputes, to go back when there is a consumer dispute to rely on more than simply the one page that they get from the debt buying agencies.

We are trying to attack the accuracy issue in a number of ways. Most critically, we are engaged in a massive study on the accuracy to get a better sense of what causes these errors and how we can better fix them. The accuracy studies are an ongoing process, but we hope to be able to provide answers to the questions about accuracy within the next year to 18 months.

Mr. GREEN. Thank you, sir. If I may, I am going to ask if you would respond in writing, and we will go on to Ms. Kilroy with a terse question, if at all possible, please.

Ms. KILROY. Thank you. When you take a look at the scoring systems that the various credit reporting agencies use in order to determine whether or not they are using a proxy that would have a discriminatory impact, have you taken a look at such issues as whether or not everyone in a particular Census track is penalized with their credit scores based on the number of foreclosures in the area, or looked at other kind of micro-targeting issues that a credit scoring company might utilize as many direct mail and other kind of marketers do? Even politicians use micro-targeting these days.

Mr. GREEN. Thank you. We will ask, if you would, to submit your answers in writing. We are beyond the time for the vote. We are beyond zero. Some of the members are going to have to rush over for this vote.

At this time, I would like to indicate that the Chair notes that some members may have additional questions for the witnesses which they may wish to submit in writing, and I will be one of them. Therefore, without objection, the hearing record will remain open for 30 days for members to submit their written questions to the witnesses and to place their responses in the record.

The subcommittee hearing is now adjourned. Thank you so much.

[Whereupon, at 5:00 p.m., the hearing was adjourned.]

A P P E N D I X

March 24, 2010

LVG Opening Statement for March 24, 2010 FI Hearing "Keeping Score on Credit Scores: Credit Scores, Credit Reports and Their Impact on Consumers"

As we begin this hearing on credit scores and reports, we must recognize that the American consumer faces a very different landscape than that of 30 years ago. Credit cards are so widespread that they are routinely marketed to college students; your local bank (that is, if you are lucky enough to have one in your neighborhood) is more than likely owned by some faceless Wall Street Corporation and you can even shop for loans and car insurance online, something that wasn't even imagined thirty years ago.

In large part, what has made all this possible are the now ubiquitous credit scores and reports created and provided largely by the companies that sit before us today. Driven by an increasingly impersonal and homogenized lending environment, lenders, insurance companies, utilities and even cell phone companies are relying more and more on credit scores and reports

to determine whether a consumer is worthy of their attention and their services. I know the increased use of credit scores has expanded credit to previously ineligible borrowers and the standardization of this system has minimized some of the bias present in any economy, but this system has created new concerns and dangers for consumers, especially for Blacks and Latinos that we have to address.

A good credit score and a correspondingly favorable credit report have become the passport to a stable economic future for today's consumer. But these "passports" are being issued by thousands of private, for-profit companies that few can identify, using opaque formulas that are hidden from the American people and hidden from Congress.

In a democracy, there is something unseemly in having one's life judged and possibly even guided, no matter how benignly or unintentionally, by private, for-profit companies through a system where it is impossible for one to opt out of. This fact alone causes me to doubt the fairness of the current system and structure!

For instance, as Mr. Hendricks will mention in his testimony, consumers are not commonly allowed access to the scores that lenders and other institutional consumers of data actually use to make lending decisions. Instead, you are sold an "educational score" that is not the score used by the lender to determine your credit cards rates can be very different from that used to determine the rate they qualify for. So what's going on is they're selling you a product that is never actually used to make any decisions about your creditworthiness. How is that educational!?

On top of that, lenders use their own private data to further determine what rate or fee they want to charge a consumer. For an industry that is supposed to be focused solely on accuracy and predictability, there seems to be quite a bit of effort going on behind the scenes to prevent consumers from seeing how things really work. Americans do not know where these scores are coming from and how they're created!

I have strong reservations about allowing the use of credit reports to determine employability and insurance fees. For example, 22% of Latinos have 'thin files' and are given a worse rate for loans and insurance and can even lead to them being rejected for a loan! At a time when Americans are dealing with 10 percent unemployment rates (which in fact is actually higher in many of our communities), I don't believe that our constituents should have to worry about whether or not their credit report is entirely accurate or even worry about it at all when they should be focused on finding a way to pay their rent and feed their kids.

We shouldn't allow the secrecy of the current system to affect consumers' livelihoods without their knowing the rules of the game and what they can do about it before it's too late. Consumers should know that a medical debt they already paid off will affect their credit for 7 years to come, or that being away on military service might not be much of a mitigating factor for the credit bureaus and institutional consumers of credit scores and reports, or that recent immigrants' creditworthiness is often lower

than the general population, regardless of how good their credit history was in their home country. These are just some of the concerns that make it clear that the current system has not reached acceptable levels of fairness or transparency.

Finally, I have serious concerns that with banks and others taking credit away from consumers due to the bank's own problems (not the consumers), your formulas are not accurately predicting a consumer's true likelihood of default. Just because some bank is consolidating the credit lines they have out there for ALL their customers doesn't mean that every single one of them is a greater credit risk.

There are many legislative proposals circulating right now on credit scores and reports, some that I have cosponsored and some that I plan to introduce myself. We will be holding further hearings on these proposals after we give a harder look at credit-based insurance scores in the near future. Many of the concerns that I have are with the institutional consumers of credit scores and reports, so I can assure you that we will be inviting them to sit

down and have their own 'pleasant' discussion with our subcommittee about this as well.

Statement of Congressman Ron Klein
Hearing of the Subcommittee on Financial Institutions and Consumer Credit
"Keeping Score on Credit Scores: An Overview of Credit Scores, Credit Reports and their Impact on Consumers"
March 24, 2010

Thank you, Chairman Gutierrez, for holding this hearing. Many people have expressed concerns that recent economic conditions have significantly harmed consumer credit scores, making it harder for individuals to get loans or even a job. Given the increasing significance that consumer credit scores have in today's economy, it is important that we carefully examine their impact on everyday Americans.

One serious problem in South Florida is the treatment of loan modifications, short sales, and other foreclosure prevention measures by credit bureaus. The Obama Administration has responded to the decline in real estate prices with loan modification programs designed to help borrowers make their mortgage payments and stay in their homes.

Preventing foreclosures is important because when a house is foreclosed on it brings down the values of surrounding property, and also requires banks to acquire the property and take significant losses. It is often in the interest of all parties involved in a mortgage transaction and the community at large to prevent foreclosures. Yet while these loan modifications are important for community stabilization and economic growth, these programs can still have serious negative consequences for homeowners. I hear from my constituents that credit scores are often significantly dropped when an individual engages in a loan modification or short sale, though less than with a foreclosure, and that many are unaware of the effect a loan modification will have on a credit score. It is understandable that credit bureaus would look at any event involving mortgage payments, but given the current economic environment this committee should look at mitigating the negative effects of loan modifications on consumer credit scores for responsible individuals that are doing the right thing.

I think it is important to devise a solution that will lessen the negative impact of a loan modification on credit scores given current economic conditions. I look forward to working with this committee on this issue and other important issues involving consumer credit scores.

For release on delivery
2:00 PM EDT
March 24, 2010

Statement by

Sandra F. Braunstein

Director, Division of Consumer and Community Affairs

Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions and Consumer Credit

Financial Services Committee

U.S. House of Representatives

March 24, 2010

Chairman Gutierrez, Ranking Member Hensarling, and members of the Subcommittee, thank you for this opportunity to address credit scoring and the role of the Federal Reserve Board (FRB) in ensuring that lenders use credit scoring systems appropriately to evaluate consumers' credit risk. In my testimony, I will (1) discuss our examination processes for credit scoring systems, both for fair lending and safety and soundness; (2) outline the findings of the Board's 2007 report on credit scoring and its effects on the availability and affordability of credit, particularly for protected and historically underserved populations; and (3) describe the new rules for creditors that engage in risk-based pricing based on credit report information, which will likely result in many more consumers receiving their credit scores and related information without charge.

The Board has three roles in connection with 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.

In addition, the Board has shared rulemaking authority with other regulatory agencies under the Fair and Accurate Credit Transactions Act of 2003 (FACT Act), which amended the Fair Credit Reporting Act (FCRA). The Board, acting jointly with the Federal Trade Commission (FTC), issued new rules under the FCRA regarding risk-based pricing in January 2010. Greater disclosure of credit scores to consumers is a likely outgrowth of those rules.

Second, as a supervisor of financial institutions, the Board conducts fair lending examinations to ensure that financial institutions are using credit scoring models that comply with ECOA and other applicable fair lending laws, and takes enforcement action if it finds

violations. The Board also conducts safety and soundness examinations to ensure that financial institutions use credit scoring models in a safe and sound manner.

Third, as research institutions, the Board and Reserve Banks study significant trends in credit markets, such as the use of credit scores and credit scoring models; publish their research; and encourage research by other parties as well.

Background on Credit Scoring Systems and the Equal Credit Opportunity Act

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 many types of consumer credit, including 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 improved market efficiency.

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. Therefore, the 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 subsequent loan repayment performance and to determine how these relationships vary for the population groups protected under ECOA. The Congress also directed the Board to study the extent to which consideration of certain factors in credit scoring systems could have a negative effect on protected populations, as well as the extent to which alternative factors could achieve

comparable results with less negative effect on protected populations.[1]

Equal Credit Opportunity Act

ECOA generally prohibits creditors from discriminating against a credit applicant on a prohibited basis (such as race, national origin, age, or sex) in a credit transaction. ECOA is implemented by the Board's Regulation B.

Under ECOA and Regulation B, lenders are prohibited from using credit scoring systems that take into account any prohibited basis, except for age. Lenders are not permitted to use a credit scoring system that considers race, color, religion, national origin, or sex to evaluate an applicant's creditworthiness. ECOA and Regulation B allow lenders to consider age as a predictive factor in an empirically derived, demonstrably and statistically sound, credit scoring system (validated system).[2]

A credit scoring system is a validated system if it is (1) based on empirical data that compares sample groups or actual populations of creditworthy and noncreditworthy applicants within a reasonable time period; (2) developed to calculate the credit risk of applicants for legitimate business purposes, such as minimizing bad debt losses; (3) developed and validated using accepted statistical methods; and (4) periodically revalidated using the same standards.

Any system that does not qualify as a validated system is classified as a judgmental

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[1] In section 215 of the FACT Act, the Congress directed both the Board and the FTC to study the effect of credit scoring on the availability and affordability of financial products and then 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 of Governors of the Federal Reserve System (2007), *Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit* (Washington: Board of Governors, August), www.federalreserve.gov/boarddocs/rptcongress/creditscore/default.htm). 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 (see Federal Trade Commission (2007), *Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance* (Washington: FTC, July), www.ftc.gov/os/2007/07/P044804FACTA_Report_Credit-Based_Insurance_Scores.pdf. The FTC is preparing a separate report on homeowner's insurance.

[2] Under ECOA and Regulation B, a lender can consider age to ensure the applicant has the capacity to enter into a contract or when age is used to favor a credit applicant who is age 62 or older. For example, if a lender assigns "points" to applicants in its credit scoring system, a credit applicant who is age 62 or older must receive the same or a greater number of points than a younger applicant when calculating the credit score.

system under Regulation B. In judgmental systems, lenders are limited to considering age only for the purpose of determining a "pertinent element of creditworthiness."[3] For example, age may not be considered directly, but it can be used if it relates to other information used to evaluate creditworthiness, such as to assess the significance of length of employment (for instance, in the case of a young credit applicant that recently entered the job market).

Lenders must revalidate these systems frequently 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 population of applicants used to validate the system. Lenders may also use validated systems that are developed by third parties. However, lenders retain responsibility for ensuring that these systems comply with Regulation B.

Examiners and lenders look to the Regulation B standard as a useful benchmark for fair lending compliance and for safety and soundness when evaluating a credit scoring system, even when age is not used as a predictive variable. When a credit scoring system is a validated system, there is a greater degree of confidence that the system is predictive of risk and does not have a disparate impact on a protected population or otherwise pose substantial fair lending compliance risks.[4]

Properly constructed credit scoring systems instill objectivity into the credit evaluation process. Well-constructed systems apply the same criteria to all credit applicants without consideration of prohibited bases, such as race, sex, and, to a limited extent, age. Credit scoring

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[3] See Regulation B § 202.6(b)(2)(iii).

[4] 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 occurs when a practice is neutral on its face because it applies equally to all applicants, but has a disproportionately negative impact on a protected group, unless the practice meets a legitimate business need that cannot be met as well by other means with lesser effect.

systems may help lenders facilitate consistency and limit lender discretion in the credit evaluation process, and thus promote fair lending.

Examination of Credit Scoring Systems

Fair Lending Examinations of Credit Scoring Systems

As a supervisor of financial institutions, the Board has a long-standing commitment to ensure that every institution it supervises complies fully with the federal fair lending laws (ECOA and the Fair Housing Act). The Board has a dedicated Fair Lending Enforcement Section, which provides legal and statistical support to examiners and ensures that fair lending laws are enforced rigorously. And 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. [5] Based on this risk assessment, examiners identify the specific business lines on which to focus, and in each examination they evaluate in detail at least one product or class of products. As appropriate, examiners 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 developed for the institution's own use, examiners review all of the factors considered within the system. First, examiners ensure that prohibited bases, with the exception of age, are not used in the scoring system. If a credit scoring system considers age, examiners ensure that it meets the appropriate standards for a validated system pursuant to Regulation B. As a practical matter, we find that few lenders consider age in credit scoring systems.

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[5] The Interagency Fair Lending Examination Procedures are included in the Consumer Compliance Handbook, which is available at www.federalreserve.gov/boarddocs/supmanual/cch/200911/fair_lend_proc.pdf.

Second, examiners consider whether any factors used in the credit scoring 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 predictive power and whether other factors might be used instead. Finally, examiners review how the credit scoring system is used by the institution, focusing on whether the system is applied consistently to all consumers and whether it is used in a manner that may have an illegal disparate impact.

The Board also supervises many institutions that do have their own proprietary credit scoring systems, but rely on third-party credit scoring systems. The review process for third-party systems is similar to the review of an institution's proprietary system. If examiners have questions about the factors utilized in the system, the institution is directed to obtain the appropriate information from the third-party developer.

In the current economic environment, the Board is paying special attention to scoring systems that are used within the loss mitigation process. For example, institutions may develop credit scoring models that provide input into loss mitigation decisions, such as decisions to modify mortgages.

Safety and Soundness Examinations of Credit Scoring Systems

As a supervisor of financial institutions, the Board has a long-standing commitment to ensure that every institution it supervises conducts its business in a safe and sound manner. The Board recognizes the importance of ensuring that internal credit scoring models used by financial institutions produce results that assist them in assessing repayment risk and help them to meet the credit needs of creditworthy borrowers.

For internal credit scoring models used at Board-supervised institutions, the Board's Commercial Bank Examination Manual provides guidance to examiners for reviewing key elements of validated systems.[6] Examiners review the items or customer attributes that are included as factors in a financial institution's credit scoring system. Examiners also evaluate whether the model's risk measurement is based on historical data, measures the risk of default, and produces consistent results across time for a wide range of borrowers. Finally, examiners assess certain third-party vendor models for appropriateness and ensure that financial institutions understand the limitations of such models.

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, and credit has been made available to a broader spectrum of consumers. The development and use of credit scores has greatly facilitated these trends. Credit scores 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 and price new and existing credit accounts. It is also used to facilitate decisionmaking 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 the Congress in the FACT Act, the Board prepared a report in 2007 on a number of matters regarding credit scoring, including how it has affected the availability and

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[6] The Commercial Bank Examination Manual is available at www.federalreserve.gov/boarddocs/supmanual/cbem/200910/0910cbem.pdf.

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.[7]

Background on the Report

There is a lack of data linking credit scores to relevant demographic information. With the exception of dates of birth, the credit records maintained by the consumer reporting agencies, which serve as the basis for most credit scoring systems, do not include any personal demographic information. As a result, little research has been conducted on credit scoring and its potential effects on minorities and other protected demographic segments of the population. For this reason, the findings of the Board's report, which are based on the research conducted by the Board staff specifically for this study, are significant.

In addition to reviewing public comments, previous research, studies, and surveys, the Board staff conducted unique research specifically to develop information needed to prepare its report. The Board staff created a database that, for the first time, combines information on personal demographics collected by the Social Security Administration 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.[8] Because the data set consisted of the credit records of the same individuals for both these dates, the Board staff was able to construct measures of loan repayment performance, credit availability, and credit affordability and to create its own credit scoring model (the FRB base model) and credit scores (FRB scores).[9]

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[7] See Board of Governors, *Report to the Congress on Credit Scoring*, in note 1.

[8] Personally identifiable information of the individuals in the sample, such as names and Social Security numbers, was not made available to the Board.

[9] 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. For details about the FRB model, see Board of Governors, *Report to the Congress on Credit Scoring*, in note 1.

The design of the FRB base model followed general industry practice to the extent possible. This 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.

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.

Access to credit. The evidence from public comments received for this study, a review of previous research, and 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 solicit the business of their competitors' customers more readily 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 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, as well as the relationship between credit scores and subsequent loan performance, availability, and affordability across populations.

Credit score variation. Credit scores differ among subpopulations: Available evidence shows that blacks, Hispanics, single people, those younger than 30, and people residing in low-income or predominately minority census tracts have lower credit scores, on average, than

people in 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 information in their credit records, 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 Board's 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.

Loan performance. The study analyzed whether loan repayment performance differed across population groups after controlling for credit scores. For every performance measure evaluated, such as delinquencies on new loans, and for every population group considered, the study found that credit scores consistently rank-order the credit risk of individuals. In other words, 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, a key finding of the Board's study is that those with worse credit scores consistently perform more poorly on loans than those with higher scores; this relationship holds for each racial or ethnic group, and regardless of age or sex.

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 estimates of loan denial and loan pricing. For all populations, interest rates and average estimated denial rates consistently decline as credit scores increase. Some differences were observed across population groups after controlling for credit score. Most notably, younger people appear to experience somewhat higher estimated denial rates than older people; 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 for every category of loans 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 factors lenders consider in underwriting and pricing credit, such as a credit applicant's income and assets, down payments, employment experiences, or wealth.

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. Despite this prohibition, a factor could be impermissibly included in a credit scoring model 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, rate of credit utilization, and months since recent delinquency) included in credit scoring models generally, and in the FRB base model, correlated with prohibited demographic characteristics. Therefore, the study found that such credit

characteristics are unlikely to serve as proxies for demographic characteristics. An 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, ethnicity, sex, or age, the FRB base model was reestimated in race-neutral, ethnicity-neutral, age-neutral, and sex-neutral environments. 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 reestimated model. Credit characteristics that have both an independent effect on loan repayment performance and a correlation with race, ethnicity, age, or sex would be expected to have significantly different weights (either larger or smaller) in the reestimated models.

Reestimating the FRB base model in a race-, ethnicity-, 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 as proxies for race, ethnicity, or sex. However, when the model is reestimated in an age-neutral environment, credit scores did change slightly. Scores for recent immigrants and younger individuals fell, and scores for older individuals rose. 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. Thus, excluding the length of credit history would not only reduce the overall predictive power of the model, but would also have a significant age-related effect by lowering the scores of older individuals and raising the scores of younger individuals.

The study 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 people, whose credit performance is poor relative to the rest of the population. To address this concern, the length of credit history could be excluded from models, but that would create other problems including loss of predictive power for the credit scoring model. Another approach would be to expand the information supplied to credit reporting agencies to gain a broader picture of the credit experiences of recent immigrants, among others. Such information could include rent, utility, and other recurring bill payments.

Risk-Based Pricing Final Rules and Access to Credit Scores

In January 2010, the Board and the FTC (collectively, the Agencies) jointly issued final rules to implement the risk-based pricing provisions of the FACT Act.[10] Risk-based pricing is the practice of setting or adjusting the price of credit offered or extended to a consumer to reflect the risk of nonpayment by that consumer. Information from credit reports is often used in evaluating this risk. Creditors that engage in risk-based pricing generally offer more-favorable terms to consumers with good credit histories and less-favorable terms to consumers with imperfect credit histories.

In the past, consumers with imperfect credit histories were denied credit. Under the FCRA, when a consumer is denied credit based on information in a credit report, the consumer must be given an adverse action notice and the right to obtain a free copy of his or her credit report. This enables the consumer to check the report for accuracy.

The development of risk-based pricing made it possible for creditors to grant credit to consumers who in the past would have been denied credit, but at a higher price than the creditors would charge to consumers with better credit histories. Such consumers, however, do not

[10] The mandatory compliance date for the risk-based pricing rules is January 1, 2011.

receive adverse action notices. The risk-based pricing provisions were designed to give consumers who were granted credit on less-favorable terms protections similar to those afforded to consumers who are denied credit.

Under the risk-based pricing rules, a creditor that engages in risk-based pricing generally must provide a risk-based pricing notice to a consumer when the creditor uses a credit report to extend credit to a consumer on terms that are not as favorable as the terms it has provided to other consumers. The statute requires creditors to provide a risk-based pricing notice when a consumer applies for, or is granted, credit "on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers" from the creditor, based on a credit report.[11] Essentially, this requires a direct comparison between the material terms granted to a consumer and the material terms granted to some reference group of other consumers by the same creditor.

Practical Challenges in Implementing the Statute

The Agencies found significant practical problems with requiring creditors to make a direct comparison of the terms offered to different consumers. To make such comparisons, each creditor would have to identify, for each type of credit product it offers, a group of consumers who received credit on its "most favorable" material terms that can serve as the appropriate benchmark against which to compare the terms offered to other consumers.

It could be exceptionally difficult to identify appropriate benchmarks for two reasons. First, for many types of credit, there is no single set of "most favorable" terms, because consumers can make tradeoffs between different credit terms. For example, some consumers may make a larger down payment or take a loan with a shorter duration in order to get a lower annual percentage rate, while other consumers may pay a higher annual percentage rate in order

[11] See 15 U.S.C. § 1681m(h)(1).

to make a smaller down payment or have a longer period of time to repay the loan. Second, the substantial numbers of product variations that are available for certain types of credit make it difficult to establish appropriate benchmarks for making comparisons. For example, mortgages include, among other variations, fixed- and adjustable-rate options; repayment periods of 10, 15, 20, and 30 years; a variety of down payment options; and options to pay points in exchange for a lower rate.

Similarly, the number and variety of credit products make it difficult to specify when terms are "materially less favorable" than other terms. For example, an annual percentage rate that is 1/2 percentage point higher than the lowest available rate may be materially less favorable for a 30-year fixed-rate mortgage, but not for a credit card.

In addition, a creditor must have a sufficient number of similar transactions that it can use to establish appropriate benchmarks and make comparisons. Small banks and other creditors that make a relatively small number of certain types of loans may not have a sufficient number of similar transactions to enable them to establish benchmarks and make comparisons. Finally, any comparisons would have to take into consideration changes in market conditions, underwriting standards, and product offerings that occur over time.

Objectives for the Risk-Based Pricing Rules

The Board and FTC staff conducted extensive outreach to interested parties in developing the risk-based pricing rules. Based on this outreach, the Agencies concluded that the best way to implement the statute was to develop a number of alternative approaches that creditors could use to comply with the rules in addition to directly comparing the material terms offered to different consumers. The Agencies concluded that no single approach would be practical for all of the

types of creditors to which the rules apply or for all of the types of credit products for which risk-based pricing is used.

In developing these alternatives, three objectives were paramount. The first objective was to provide consumers with meaningful, personalized notices, rather than generic notices that they would likely disregard. The second objective was to provide notices at a time when the information would be helpful to consumers. The third objective was to ensure that all creditors had a practical means of complying with the rules.

To satisfy the first and second objectives, the final rules generally require risk-based pricing notices to be provided *after* the terms of credit have been set, but *before* the consumer becomes contractually obligated on the credit transaction. The third objective is addressed by providing creditors with alternative methods for complying with the rules.

Alternatives for Complying with the Risk-Based Pricing Rule

The final rules provide creditors with four alternative methods for complying with the risk-based pricing rules: (1) the direct comparison method, (2) the credit score proxy method, (3) the tiered pricing method, or (4) the method of providing a credit score disclosure instead of a risk-based pricing notice. Under the first three methods, some consumers will receive a risk-based pricing notice and can contact the credit bureau to obtain a free copy of their credit report. Under the fourth method regarding the credit score disclosure alternative, consumers who apply for credit receive a free credit score and information about their score in the notice. Each method is discussed briefly below.

Direct comparison method. The direct comparison method, set forth in the statute, allows creditors to directly compare the material terms offered to different consumers to determine which consumers must receive risk-based pricing notices. In the final rules, the

Agencies tried to make this method feasible, for example, by defining "material terms" as the annual percentage rate for most types of credit. Still, most creditors are not likely to use this method.

Credit score proxy method. The credit score proxy method permits a creditor that uses credit scores to determine a "cutoff score." The cutoff score generally represents the point at which approximately 60 percent of the creditor's consumers have lower credit scores and 40 percent of the creditor's consumers have higher scores. Creditors then must provide a risk-based pricing notice to each consumer who has a credit score lower than the cutoff score. This method targets the notice to consumers likely to receive less favorable terms because consumers with lower credit scores generally receive less favorable terms than those with higher credit scores. A creditor must recalculate its cutoff score every two years.

Tiered pricing method. The tiered pricing method permits a creditor that assigns each consumer to one of a discrete number of pricing tiers, based on a credit report, to provide a risk-based pricing notice to each consumer who is not assigned to the top pricing tier or tiers. Generally, a notice must be provided to each consumer who is not assigned to the top 30 to 40 percent of the pricing tiers. For example, if a creditor has three pricing tiers, the notice must be provided to those consumers placed in the bottom two tiers; if a creditor has five pricing tiers, the notice must be provided to those consumers placed in the bottom three tiers.

Credit score disclosure method. Creditors may provide consumers with a free credit score and a credit score disclosure as an alternative to providing risk-based pricing notices. To use this alternative, creditors generally must provide a credit score disclosure to all consumers who apply for credit, unlike the risk-based pricing notice which is only provided to those consumers who likely will receive less favorable credit terms. The credit score disclosure must

be provided as soon as reasonably practicable after the credit score is obtained, but before the consumer is obligated for the credit transaction.

The credit score disclosure must include the consumer's credit score, the source of the score, the date the score was created, and the range of possible scores. In addition, the credit score disclosure must tell the consumer how his or her credit score compares to the scores of other consumers using a short narrative statement or a bar graph. The credit score disclosure also informs the consumer of the right to request a free annual credit report from each of the three nationwide credit bureaus, along with contact information.

The credit score disclosed to the consumer generally must be a score used by the creditor. For example, if a creditor obtains three credit scores, but uses the middle score in its credit evaluation, the credit must disclose the middle score. Creditors that use their own proprietary scores, however, are not required to disclose those scores because those scores often take into consideration information not contained in a credit report and disclosing those scores could be confusing for consumers.

The credit score disclosure alternative was created using the Agencies' authority to create exceptions to the risk-based pricing notice requirement in circumstances where they determined that notice would not significantly benefit consumers. The Agencies determined that the information in a credit score disclosure would be of equal or greater value to consumers than the more generic information contained in the risk-based pricing notice. Today, consumers must pay to obtain a credit score, unless they are applying for a mortgage loan. Under this alternative, the consumer will obtain this important, personalized credit score information automatically, for free, and without having to request a credit report or credit score from a consumer reporting agency.

I expect that many creditors will rely on the credit score disclosure exceptions to satisfy the requirements of the risk-based pricing rules. If that happens, consumers will gain greater access to their credit scores and more information about them.

Conclusion

This concludes my testimony regarding the Board's multifaceted role with regard to credit scoring as a rule writer, bank supervisor, and research institution.

VANTAGESCORE®

Testimony of

Barrett Burns

President and Chief Executive Officer
VantageScore Solutions, LLC

Before the

Subcommittee on Financial Institutions & Consumer Credit

Committee on Financial Services

United States House of Representatives

Hearing on

"Keeping Score on Credit Scores: An Overview of Credit Scores, Credit Reports and Their Impact on Consumers"

March 24, 2010

Introduction
Good afternoon Chairman Gutierrez, Ranking Member Hensarling and members of the Subcommittee. My name is Barrett Burns and I am president and CEO of VantageScore Solutions. I'd like to thank the Subcommittee for the opportunity to testify today, providing an overview of credit scores and how they work.

About VantageScore
VantageScore Solutions is a joint venture of the three credit bureaus, Equifax, Experian and TransUnion. We were formed in 2006 to offer choice and competition in the credit score marketplace by providing a highly predictive credit score based on the latest analytic methodologies. Each of the three credit bureaus devoted teams composed of their top scientists and analytic leadership to the development of our credit score. Armed with a collective deep understanding of consumer risk modeling and their respective bureau's database design, team members spent several months building a new consumer credit score from the ground-up. Fifteen million anonymous consumer files were used as the basis for development and testing prior to release of the new model. These anonymous consumer files reflected the latest trends in consumer behavior, including a doubling of mortgage debt in the five years preceding development and the high percentage of subprime mortgages which peaked during that timeframe as well. Other innovative approaches in the model's development included advanced segmentation techniques that provide more scorecards than many traditional models, including separate segmentation scorecards for full file and thin file consumers, as well as segmenting consumers with a previous bankruptcy into high-risk and low-risk tiers.

The result is VantageScore®, a new consumer credit score that remains highly predictive, even in this changed economic environment. Through these advanced development techniques, VantageScore can score people who historically have had trouble getting a score with traditional credit score models. Additionally, one of the biggest points of confusion for consumers and lenders alike with credit scores is the inconsistency seen when obtaining credit scores. VantageScore tackles this issue by using the same algorithm for each bureau's data which reduces the variance. I will go into additional details about these benefits as I talk more about the application of credit scores.

The addition of VantageScore in the marketplace has reduced the concentration of risk that existed when a dominant provider was serving the majority of the market.

Since our introduction there has been significant marketplace adoption of VantageScore as well as regulatory recognition of the important contribution made by VantageScore. VantageScore is used by many lenders, including:

- 4 of the top 5 financial institutions
- 8 of the top 10 credit card issuers
- 3 of the top 10 mortgage originators
- 7 of the top 50 auto lenders.

VantageScore was also recognized by the Federal Reserve when our product was used in their analysis of credit scoring as part of the FACT Act report to Congress in 2007. Our company executives, including our chief analytic scientist, meet regularly with officials from Treasury, The Federal Housing Finance Agency (FHFA), the Federal Deposit Insurance Corporation (FDIC), the Federal Housing Administration (FHA), the Office of the Comptroller of the Currency (OCC) and the Federal Reserve to provide analysis of

consumer debt behavior and to review understanding about the impact on credit scores from various marketplace events.

Impact on Credit Scores from Loan Modifications
Many in the Administration, several non-profit organizations such as the Hope Now Alliance, and many people at Fannie Mae and Freddie Mac are working hard to keep Americans in their homes during this prolonged economic crisis. Numerous programs, such as the Making Home Affordable effort, have been implemented and additional solutions are regularly being suggested or considered to help reach this goal.

VantageScore Solutions just completed a study describing the impact on a consumer's credit score from various mortgage restructuring options, such as forbearance, loan modifications or short sales. We reviewed the study results with several regulators and various government agencies. The good news is that the study shows the mortgage mitigation programs have little, if any, impact on a consumer's credit score. The impact is far greater when a consumer becomes delinquent on debt payments, especially delinquent on a mortgage. For this reason, we applaud the efforts by the Administration and the financial services industry imploring homeowners to contact their lenders before the homeowner becomes delinquent.

The study has additional good information should a homeowner become delinquent. There is significant benefit to homeowners who work with lenders to structure a mortgage modification that also allows sufficient monthly cash flow to bring all other delinquent debts current. Although a credit score may have deteriorated, generally, once a homeowner brings both their mortgage and other debts current through a modification and sustains that current status for approximately nine months, their VantageScore credit score can return to a prime credit tier. The study is attached as Appendix I.

Credit Scoring Background
With the continued turmoil in our nation's economy, this is a critical time for consumers, lenders, government agencies and other parties to fully understand the use and impact of credit scoring.

There are literally hundreds of credit scores and scoring models in use today by lenders. There are many scores that are used in unique applications, such as scores used by insurance companies and cell phone providers or custom models that are designed for specific lenders. VantageScore's only model is the initial algorithm which is designed as a consumer credit score. Therefore, my testimony will address generic credit scores used for consumer lending purposes.

Lenders' appetite for risk adjusts when economic and market factors change. Credit scores offer a uniform, non-judgmental mechanism that can be quickly deployed system-wide within an institution in order to respond to changing credit conditions. Prior to the introduction of automated credit scores, lenders would have hundreds – or sometimes thousands – of loan officers across the country individually evaluating credit files. These loan officers would obtain copies of applicants' credit files and use a combination of their own judgment and corporate criteria to interpret the credit file. Their personal interpretation of consumer credit files was part of the loan decision. It is difficult to apply fair and unbiased judgment in a uniform manner under this scenario.

Today, automated credit scores have, in large part, replaced the subjective human element in interpreting credit files. Lenders use credit scores in three primary areas: pre-select marketing efforts, originations and on-going management of their customer accounts. We believe that credit scores

should be a part of any decision process for credit approval but not the sole criterion. Approving large loans without also verifying other critical information needed to assess a consumer's ability to repay the loan, such as employment, income level or assets, is simply not prudent.

Purpose of a Credit Score
VantageScore rank orders consumers on the likelihood of becoming 90 days or more past due on a credit obligation within a two year window. The higher the numerical value of the score, the less probable that such a delinquency will occur. Fewer people at the higher end of the score range will become delinquent, while more people at the lower end of the scale will become delinquent.

The numerical value of all credit scores is tied to an odds table that translates the score value into the actual probability of the 90-day delinquency occurring. These odds tables are generated for each lender's unique portfolio. For example, a VantageScore credit score of 990 may represent a 0.13% chance of becoming late, while a 501 VantageScore could mean a 48% chance of the consumer becoming 90 days or more late.

Benefits of Accuracy in Credit Scores
An accurate credit score model aids the safety and soundness of our country's financial system. When lenders employ accurate credit score models tied to sound underwriting policies, risk is more appropriately delineated. In addition, lower operational costs are realized through automation and overall portfolio risk is reduced.

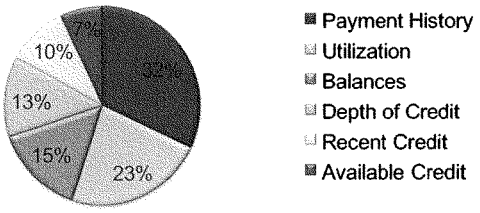
Consumers also benefit with accurate credit scoring systems because the cost of credit is reduced through the elimination of expensive manual underwriting processes. Additionally, consumers receive credit offers that are better matched to their risk profile, providing better protection from over-extension of credit (provided that appropriate underwriting is also employed). Finally, credit scores deliver an incentive for borrowers to adopt better financial habits in order to receive the best terms and conditions.

Factors used by VantageScore
The VantageScore development team, comprised of the top analytic scientists from each of the nation's three largest credit bureaus, used 15 million anonymous consumer credit files from all three major credit bureaus to evaluate behavioral consumer characteristics in combination with innate factors that exhibit the best performance at consistently predicting future credit conduct. The best performing 195 characteristics and factors were applied to patent-pending analytic techniques to produce a sophisticated algorithm that industry influencers agree is a highly predictive credit score.

There are six categories of consumer behaviors and factors within the VantageScore algorithm that are used to calculate a consumer's VantageScore credit score. The approximate weighting of each factor is:

- Payment History (32%) – whether previous payment patterns have been reported as satisfactory, delinquent or derogatory. Paying debt obligations on time is the single biggest action consumers can take to positively influence their credit score.
- Utilization (23%) – the percentage of credit amount used or owed on accounts.
- Balances (15%) – the amount of recently reported balances, both current and delinquent.
- Depth of Credit (13%) – the length of credit history and types of credit.

- Recent Credit (10%) – the number of recently opened credit accounts and credit inquiries.
- Available Credit (7%) – the amount of credit available.



We have posted this information on our website so that consumers may understand how their credit behavior correlates to their VantageScore credit score.

What's not in a Credit Score
Just as important as what is in a credit score is the information that is *not* considered by credit score algorithms in the calculation of a consumer credit score. All credit scoring systems must meet the regulations outlined in Regulation B, the Federal Reserve's regulation implementing the Equal Credit Opportunity Act of 1974. As a result, VantageScore does not, among other things, consider race, gender, age or income in the calculation of its scores.

Additionally, VantageScore does not factor medical debt into the calculation of a consumer's VantageScore credit score.

The VantageScore Scale
The scale chosen for VantageScore is also meant to be consumer-friendly and reduce confusion. The 501-990 score approximates the academic grading scale familiar to most consumers. A letter grade is assigned to each VantageScore credit score to aid in consumer understanding. The letter scores and the score ranges to which they correlate are:

- "A" for scores between 900-990
- "B" for scores between 800-899
- "C" for scores between 700-799
- "D" for scores between 600-699
- "F" for scores below 600.

Consistency across the Three Largest Credit Bureaus
Consumer confusion is also lessened by the ability of VantageScore to provide more consistent scores across all three major bureaus because there is only one version of the VantageScore algorithm and that same version is applied to the data at each of the three credit reporting companies ("CRCs"). As a result, any difference in credit scores for a consumer across the three bureaus would be attributed to data differences in the consumer's credit files at the three bureaus.

The use of the same VantageScore algorithm applied to each bureau's data has contributed to 69% of consumer scores calculated using VantageScore fall within a 20 point range among the three bureaus. This consistency serves to minimize consumer and lender confusion. Credit grantors benefit with the increased confidence of consistent credit decisions regardless of data source. Consumers benefit from a comparable risk assessment no matter which credit bureau their financial institution chooses.

A Consumer's Credit Score is Constantly Changing
Credit scores are not static. According to the Consumer Data Industry Association, the credit bureaus receive approximately 4.5 billion pieces of credit data every month, which arrive at the bureaus at various points throughout the month. Newly entered data is factored by the scoring algorithm the next time a consumer's credit score is requested. As consumers open new loans, pay down credit cards or change other payment or debt management behavior, their credit score will change accordingly. The use of the freshest data in credit files gives consumers the opportunity to impact their score, not just be impacted by it.

Scoring Thin File and other Previously Unscoreable Consumers
Millions of consumers can't obtain a credit score under some traditional models. The predictive power of VantageScore enables lenders to find more creditworthy consumers while maintaining accuracy in risk assessment. With this capability, VantageScore plays a vital role in making the mainstream credit markets more accessible to creditworthy consumers at appropriate rates and terms. Lenders can achieve higher volumes and more market share without lowering their credit standards and exposing their portfolios to undue risk, while keeping such consumers away from predatory lenders.

Through our analysis, VantageScore has identified three categories of consumers who face difficulties accessing mainstream credit markets because they are unable to obtain a score: "Thin file", "infrequent credit user" and "new entrant."

> **Thin File.** 'Thin File' commonly means "consumers with fewer than three accounts in their credit file." It is estimated that between 35 and 50 million adults in the United States – equivalent to 18 to 25 percent of the adult population – may be considered thin file. A significant number of consumers thus may be blocked from mainstream credit or incorrectly priced because lenders are unable to leverage their standard decisioning strategies with these populations. The analytical approach in the VantageScore model provides lenders with access to a larger pool of scoreable consumers while maintaining accuracy in risk assessment.
>
> **Infrequent Credit User**. The infrequent credit user is a person who may not be eligible for a score because there has not been new activity on any credit account for six months. VantageScore, however, will reach back deeper into the consumer's credit history to provide a score. These could be people who have a long and favorable credit history, but they no longer use credit because they prefer to pay in cash.
>
> **New Entrant**. As the name suggests, a new entrant is just establishing credit relationships and has not had credit open for more than the six months that some traditional models require in order to produce a score. Unlike these other credit scoring models, VantageScore will score new entrants to the credit market.

Individuals typically falling into the three categories above include:

- Young adults just starting their careers
- Recently divorced or widowed individuals with little or no credit in their own name
- Newly arrived immigrants
- Previous bankrupts
- People who shun the traditional credit products by choice
- People who have been prudent with fiscal management in their early years, perhaps paid off all debts and now use credit sparingly
- Possibly minorities. According to the National Council of LaRaza, 22 percent of Latinos have thin credit files or no credit files.

The implicit assumption is that a consumer without a credit score equates to high risk. VantageScore's ability to provide scores for many thin file consumers, infrequent credit users and new entrants allows lenders to better distinguish between good credit quality consumers and those with a clear track record of unfavorable credit behaviors. A sparse credit history and/or its lack of alignment with the data specifications of common scoring models is not necessarily a reflection of poor debt management behavior.

A comparison of VantageScore with a traditional CRC scoring model that used a random sample of mortgage customers saw an overall increase in scored consumers with VantageScore of 8.1 percent, equating to some 10 million consumers. Additionally, 2.5 million consumers from the study were more accurately indentified as higher credit quality than subprime – likely moving them away from the higher priced subprime products.

Population of consumers with a mortgage trade-line and valid risk scores			
Experian Risk Score score intervals	VantageScore scored population	Experian Risk Score scored population	Percent increase
< 840	37,200,879	35,650,730	4.3%
< 710	20,770,817	19,222,143	8.1%
< 690	18,905,850	17,361,704	8.9%
< 660	16,443,381	14,992,740	9.7%
< 675	14,743,723	13,403,763	10.0%
< 645	13,008,548	11,738,798	10.8%
< 620*	**11,968,160**	**10,746,894**	**11.4%**
Total	133,041,358	123,116,772	8.1%

Source: Experian, VantageScore Addresses Deficiencies in Traditional Scores in the Subprime Consumer Sector, (May 16, 2007), p. 2

Aiding the predictive performance of VantageScore is the ability of our model to consider "alternative data" as a factor in generating a consumer's VantageScore credit score. 'Alternative data' refers to payment obligations consumers have that aren't traditional credit products. Examples include utility bills, cell phone bills and rent payments. VantageScore will utilize the alternative data that exists in a consumer's credit file.

We would like to commend Congressman Green for both recognizing the importance of finding a way to appropriately score thin file credit applicants and for authoring the amendment included in the "Housing and Economic Recovery Act of 2008" (Public Law 110-289) directing the Federal Housing Administration to undertake a pilot program demonstrating how thin file applicants can benefit from automated scoring.

Unique Aspects about VantageScore

Several aspects of the VantageScore algorithm contribute to delivering a highly predictive score to lenders, consumers and the broader marketplace. Many of these development techniques are used for the first time in VantageScore, delivering a superior performance across multiple industries, products and lenders.

Characteristic Leveling. As the VantageScore model was developed, the team reviewed hundreds of credit characteristics in thousands of combinations and chose 195 that culminated in the best performance. The definitions for these characteristics were then standardized for application to each of the three bureau's data.

A Single Algorithm. Standardizing the characteristics for application to each bureau's data provides the opportunity to put a single algorithm in place for VantageScore at all three bureaus. When this single algorithm is used on the data, more consistent scores are produced. An additional benefit to consumers for using VantageScore is that their scores will be generated by the same VantageScore model that lenders use because there is only one version of the same algorithm in place at all three bureaus.

New Performance Definition. A new modeling approach used in the development of VantageScore contributed to VantageScore's highly predictive performance. During the design phase, the VantageScore team utilized a deeper and broader suite of consumer behavior profiles to build an algorithm that interprets the number and nature of defaults with greater accuracy when the model is put into actual use. By contrast, conventional development techniques oversimplify consumer performance behaviors during development, resulting in an algorithm that is less sensitive to the number and nature of defaults later when placed into production, resulting in less accurate risk assessments delivered to lenders.

Annual Revalidation. VantageScore performs an annual revalidation to test the continued performance of the model. The results are made public each year. The most recent revalidation demonstrated that VantageScore continues to rank order effectively. (See Appendix II).

Credit Score Knowledge Still Lacking

Despite the best intentions and efforts of public and private entities in the credit industry, consumers' knowledge of credit scores remains low. One area that continues to mystify most consumers is the use of brand names versus generic terms. The generic term for products in our industry is "credit score." However, many people may refer to credit scores as "FICO scores." FICO is the brand name associated

with score products offered by Fair Isaac Corporation. This is an important distinction to make in language in proposed legislation as well as in regulatory communications and guidelines. Using the term "FICO" in such instances unfortunately could lead lenders to believe that the legislation or regulation requires the exclusive use of a FICO score and does not allow the use of other credit scores.

All of the government regulators we have met with have embraced choice of credit scores in the marketplace. Both the Federal Reserve and FHFA have published written statements about the need for clarity in language.

- From the HOEPA rules adopted in July 2008:

  The Board also continues to believe— and few, if any, commenters disagreed— that the best way to identify the subprime market is by loan price rather than by borrower characteristics. Identifying a class of protected borrowers would present operational difficulties and other problems. For example, it is common to distinguish borrowers by credit score, with lower-scoring borrowers generally considered to be at higher risk of injury in the mortgage market. Defining the protected field as lower-scoring consumers would fail to protect higher-scoring consumers "steered" to loans meant for lower-scoring consumers. Moreover, the market uses different commercial scores, and choosing a particular score as the benchmark for a regulation could give unfair advantage to the company that provides that score.[1]

- From the FEDERAL HOUSING FINANCE AGENCY "2009 Enterprise Transition Affordable Housing Goals":

  Credit Score Terminology. The proposed rule provided a market analysis to support the proposed adjustment of the housing goals levels for 2009, and discussed the effect of tighter underwriting standards of private mortgage insurers and the reduction in mortgage insurance availability for borrowers with low credit scores. A credit reporting corporation and a credit scoring corporation commented that FHFA's analysis should not specifically reference "FICO" credit scores, stating that the reference implies endorsement of the Fair Isaac Corporation product and creates an unfair advantage. FHFA did not intend to endorse a specific product. Accordingly the market analysis in the final rule refers generally to credit scores rather than to a specific product.[2]

Thank you

Thank you for the opportunity to contribute to this important discussion. I hope the information I have shared is beneficial to the Subcommittee.

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[1] FEDERAL RESERVE SYSTEM, 12 CFR Part 226, Regulation Z; Docket No. R-1305 , Truth in Lending: Final Rule, VIII. Definition of "Higher-Priced Mortgage Loan"—§ 226.35(a), *C. General Approach*

[2] FEDERAL HOUSING FINANCE AGENCY., 12 CFR Part1282, 2009 Enterprise Transition Affordable Housing Goals, Final Rule., Paragraph J, Other Issues, p. 45

APPENDIX I

VANTAGESCORE.

Impact on Consumer VantageScore Credit Scores Due To Various Mortgage Loan Restructuring Options

January 2010

OVERVIEW

The recent economic downturn and the credit market crisis combined to produce immense pressure on American consumers and the financial services industry. Rising unemployment, the continuing decline in property values, together with much tighter credit requirements have resulted in increasing numbers of significantly delinquent mortgages and foreclosure actions. Most recently, prime loans, which represent two-thirds of all mortgages, experienced a 116.2 percent increase in serious delinquencies over the same period one year ago.[1]

To mitigate the negative impact caused by the crisis, the U.S. government and mortgage lenders developed multiple programs aimed at helping homeowners better manage their mortgage debt and meet monthly mortgage payments, ultimately hoping to stem foreclosures and allow families to remain in their homes.

These mitigation programs are gaining momentum. As reported by the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS), for example, newly initiated loan modifications and payment plans rose by 68.7 percent to more than 680,000 new home retention actions when compared with the prior quarter.[2] It was further reported that these programs resulted in lower monthly principal and interest payments on more than 80 percent of all modified loans.[3] While these results are positive, consumers and lenders alike are raising questions about how these programs affect consumers' credit profiles and especially their credit scores.

This study evaluates the effect of various mortgage programs on consumers' VantageScore® credit scores,[4] along with other consequences homeowners potentially face if unable to make timely mortgage payments: short sale, foreclosure, or bankruptcy. Given the recency of these programs, long-term consumer performance in response to these modifications remains to be seen. However, the initial impact to a consumer's credit score can be effectively modeled by emulating the restructured mortgage on the consumer's trade line. To calculate this effect, an analysis database was created by extracting a representative sample of homeowners from a national database.[5] In the analysis database, their credit profiles were changed to reflect a given mortgage restructuring program or event. Additionally, further scenarios are designed and evaluated to determine the range of score changes based on the financial magnitude of the restructured events. A final section of the study focuses on how a consumer may rehabilitate their score in order to gain access to reasonably priced credit.

[1] The OCC/OTS Report defines "serious delinquencies" as "loans 60 or more days past due and loans to delinquent bankrupt borrowers." *OCC and OTS Mortgage Metrics Report*, Third Quarter 2009, December 2009, p. 17.

[2] Ibid., p. 4.

[3] Ibid., p. 5.

[4] VantageScore is a generic credit score developed by the three major credit reporting companies, Equifax, Experian, and TransUnion.

[5] Personally identifiable information was removed from the consumer data prior to the data being furnished to VantageScore Solutions. VantageScore Solutions does not have nor maintain consumer credit files with personally identifiable information.

OVERVIEW
(Cont.)

KEY OBSERVATIONS

- Consumers and lenders should proactively seek out loan modifications before the consumer experiences a severe delinquency in their credit file. Late payments have a far greater impact on a credit score than loan modifications.
- Certain loan modifications can positively impact the score based on the recapitalization structure of the loan and whether the loan retains its original open date.
- A bankruptcy filing has the greatest impact on a consumer score and will negatively affect the consumer score for a minimum of seven years due to the presence of a public record on the consumer file.
- In order to rehabilitate consumers' scores as quickly as possible, consumers and lenders working toward mortgage restructuring should allow sufficient cash to be available to the consumer so that all other delinquent debts can be brought to current status.
- Consumers can rehabilitate their credit scores relatively quickly. Analysis has shown that even consumers whose credit score has fallen to 625 due to multiple delinquencies prior to a modification can raise their score to over 700 in as little as nine months if they bring all debts current and maintain a current status for the nine months.

SCENARIO DESIGN

Multiple programs are offered by the U.S. government and mortgage lenders to help consumers meet monthly mortgage payment obligations, including forbearance programs, refinance and renegotiation programs, the Making Home Affordable Program, Hope for Homeowners program as well as Fannie Mae and Freddie Mac streamlined loan modification programs, among others.

The overall intent of almost all programs is to lower the homeowner's monthly payment by maintaining or reducing interest rates or extending the term (from 30-year loan to 40-year loan, for example) in order to make the monthly mortgage payment affordable and sustainable. Some programs require a 3-month trial period before a loan modification is made permanent, which is the case with the Making Home Affordable Program.

Despite diverse eligibility requirements (below), programs generally drive toward one of two results:

1. Either a recapitalization of fees and past due amount, resulting in an increase in the principal after refinance or loan modifications. As a component of the recapitalization, the loan terms are often extended and/or interest rates are reduced, thereby lowering the monthly payment.
2. Or lenders agree to forgive part of the original principal, thus alleviating consumers' debt burden by reducing the balance and resulting in a lower monthly payment. The forgiven principal may or may not be recorded as a charge-off event.

SCENARIO DESIGN
(Cont.)

GOVERNMENT PROGRAM ELIGIBILITY REQUIREMENTS

	Primary Residence	Mortgage Origination	Owned or Guaranteed by Fannie Mae or Freddie Mac	Account Status	Mortgage Amount	Financial Hardship (e.g. Jump in interest rate, reduction in income, or unexpected medical bills)	Debt Burden
Making Home Affordable Programs/ Loan Modification	Yes	Before Jan. 1, 2009			<= $729,750 on first mortgage	Yes	First mortgage payment (including tax and insurance) > 31% of current gross income
Fannie Mae & Freddie Mac	Yes, and must be one unit property	Before Jan. 1, 2008	Yes	90+ days past due		Yes	First mortgage payment (including tax and insurance) > 38% of current gross income
Hope for Homeowners	Yes, and the owner doesn't own a second home	Before Jan. 1, 2008		Have made at least six payments		Yes	First mortgage payment (including tax and insurance) > 31% of gross income as of March 2008

The study uses scenarios designed to capture the relevant elements of mortgage restructuring programs that impact consumers' credit scores. Regardless of the perceived complexity of each program, the structure for recording the mortgage event can be standardized along a relatively straightforward design. The table below documents the fields that may be affected by each mortgage program or event. A comprehensive guideline for trade line documentation (Metro 2 format) can be found at the Consumer Data Industry Association's (CDIA) website: www.cdiaonline.org.

	Monthly Payment	Terms	Original Loan Amount/ Credit Limit	Current Balance	Account Status	Comment/ Status Codes[1]	Amount Past Due	Close Old/ Open New	First Mortgage	Second Mortgage
Forbearance	X					BT/AC	X	No	X	
Making Home Affordable Programs/ Loan Modification	X	X	X	X		AC		Maybe	X	
Refinancing	X	X	X	X		AC/AS/13		No	X	
Fannie Mae & Freddie Mac	X	X	X	X		AC		No	X	
Hope for Homeowners	X	X	X	X		AS/13		Yes	X	X
Short Sale				X	X	AU/13/61-65			X	
Foreclosure			X	X	X	65/89/94/BO	X		X	
Bankruptcy				X	X	Bankruptcy[2]	X		X	X

[1] The column represents reporting options which may be reflected in the credit files that are used in the VantageScore algorithm.
[2] In Metro 2, bankruptcy types are reflected in the "Consumer Information Indicator."

SCENARIO DESIGN
(Cont.)

The relevant components of each program are translated into a specific set of tradeline adjustments in consumers' credit profiles, described here:

Under forbearance programs, the borrower is permitted to make either substantially reduced monthly payments or postpone making monthly payments altogether during the forbearance period. There are generally three types of forbearance programs: interest only, reduced payment, and deferred payment. Therefore, three scenarios were created that reflect these three forebearance types. For the purposes of the study, the interest-only scenario is simulated by reducing the monthly payment amount to 25 percent of the original monthly payment amount. The reduced payment scenario is structured as 50 percent of the original monthly payment. Under the deferred scenario, no payments are made and the tradeline contains a 'D' in the terms frequency field.

With principal forgiveness, the current balance is reduced by 10 percent, 20 percent and 30 percent from the original current balance. Resulting monthly payment and term length are adjusted. Note however that these fields have immediate impact on the credit score. Scenarios are modeled under two configurations: first, where the new loan details overwrite the existing trade line so that the original age of the loan is maintained, and second where the original loan is closed and a new loan is created with the new terms. If the forgiven principal results in a partial charge-off by the lender, it is recorded as a derogatory event and the score impact is similar to that of a short sale or foreclosure.

Recapitalization: The original loan amount is increased by 10 percent, 20 percent, and 30 percent to reflect the recapitalizations of fees and past due amount. As with principal forgiveness, two configurations are analyzed – overwriting the existing tradeline while closing the old tradeline and opening a new loan with the new terms.

Analyzing historic mortgage loan size and monthly payment profile shows that the 10 percent forgiveness or recapitalization scenarios align with consumers whose mortgage payments have not been made for six months.

In some cases consumers face extreme financial situations (for example, job loss or severe income reduction) and simply cannot afford to continue paying their mortgage. This can lead to short sale, foreclosure, or bankruptcy. These events have significant impact on consumers' credit scores. This study also considers these events and their implications to the consumers' VantageScore credit scores.

STUDY APPROACH

CONSUMER PROFILES

All mortgage scenarios are evaluated on four consumer behavioral profiles:

- Population One: Consumers with clean credit files (presently current and no delinquency that has ever been greater than 30 days on any trade in the past).
- Population Two: Consumers with first mortgage in clean status, other delinquencies are present.
- Population Three: Consumers are delinquent on first mortgage, no other delinquencies are present.

STUDY APPROACH
(Cont.)

- Population Four: Consumers with delinquencies on the first mortgage and a delinquency on at least one other trade.

Approximately 100,000 consumer records[1] were randomly selected for each population according to the above criteria.

SCENARIOS FOR TESTING

Forbearance programs:

1. Interest only: 25 percent of original monthly payment amount
2. Principal plus interest: 50 percent of original monthly payment amount
3. Deferral: No payment is made

Loan modifications:

1. Principal forgiveness (with no partial charge-off). Existing loan is overwritten. Range of forgiven principal is 10 - 30 percent. In other words, the new loan amount is 70 - 90 percent of the original loan amount.
2. Principal forgiveness (with no partial charge off). Original loan is closed, new loan is established. Range of forgiven principal is 10 - 30 percent (new loan amount is 70 - 90 percent of the original)
3. Recapitalize first mortgage. Existing loan is overwritten. Range of recapitalization is 10 - 30 percent. The new loan amount is 110 - 130 percent of the original loan.
4. Recapitalize first mortgage. Original loan is closed, new loan is established. Range of recapitalization is 10 - 30 percent (110 - 130 percent of the original loan).
5. Recapitalization and principal forgiveness (as above) of both primary and subordinate loans.
6. Recapitalization on consumers with first mortgage in 90+ days past due status.

Derogatory Events:

1. Short Sale
2. Foreclosure
3. Foreclosure initiated, payments received after process initiation
4. Bankruptcy

[1] Personally identifiable information was removed from the consumer data prior to the data being furnished to VantageScore Solutions. VantageScore Solutions does not have nor maintain consumer credit files with personally identifiable information.

STUDY APPROACH
(Cont.)

For each test the average VantageScore credit score was calculated for each population before any changes were made, which is noted as the starting/benchmark score. Relevant tradeline fields were edited to reflect the scenario designs, and the VantageScore credit score was recalculated after the changes were made. The resulting score changes were then compared to the benchmark score and reported. Tests were run for each scenario and for each of the four consumer populations (except the final loan modification scenario which applies only to highly delinquent consumers).

CONSUMER SCORE REHABILITATION ANALYSIS

A final analysis was run to demonstrate a score rehabilitation process after implementation of one of the mortgage restructuring events (e.g. loan modifications). The intent of the analysis is to provide a general guideline for the time required for a consumer to restore their score to a reasonable credit tier after having become significantly delinquent and then processing a loan modification. Two scenarios are evaluated:

1. Due to the loan modification (reduced monthly mortgage payment), the consumer is able to pay ALL debts on time and continues to pay all debts on time for an extended timeframe; and

2. Due to the loan modification (reduced monthly mortgage payment), the consumer is able to pay only the mortgage on a timely basis and continues to pay the mortgage debt on time for an extended timeframe but remains delinquent with other debts.

The consumers' VantageScore credit scores are calculated at three, six, 12 and 24-month intervals after the event.

RESULTS AND OBSERVATIONS

CONSUMER PROFILE DEMOGRAPHICS

Average trade status	All trades clean	First mortgage clean, other trades delinquent	First mortgage delinquent, other trades clean	First mortgage delinquent, other trades delinquent
Total # of Open Trades	10.72	10.89	9.54	6.67
# of Open Trades 30+dpd*	0.03	0.15	0.66	1.16
# of Open Trades 90+dpd	0.00	0.02	0.14	0.34
Total # of Open Bankcard Trades	3.56	3.48	2.81	1.75
# of Open Bankcard Trades 30+dpd	0.01	0.04	0.03	0.16
# of Open Bankcard Trades 90+dpd	0.00	0.01	0.00	0.04
Total # of Open Auto Trades	0.61	0.63	0.68	0.65
# of Open Auto Trades 30+dpd	0.00	0.02	0.02	0.13
# of Open Auto Trades 90+dpd	0.00	0.00	0.00	0.01
Total # of Open Mortgage Trades	1.59	1.95	2.04	1.25
# of Open Mortgage Trades 30+dpd	0.01	0.05	0.56	0.64
# of Open Mortgage Trades 90+dpd	0.00	0.01	0.14	0.22
VantageScore	862	830	722	625

*DPD: Days Past Due.

Two important insights are observed:

1. As consumer behavior reflects greater default levels, their credit score drops significantly. On the VantageScore scale of 501 to 990, the difference between a consumer who has no delinquencies and a consumer who has delinquency and defaults on all primary trades (mortgage, auto and credit card) is an average of 237 points.

2. Comparing the impact of mortgage delinquency to all other delinquencies shows the importance of maintaining the mortgage in current status. Consumers with delinquency on only auto and card trades had an average score of 830, but consumers with their mortgage in delinquent status yet maintained current status on their auto and card trades had an average score of 722.

RESULTS AND OBSERVATIONS
(Cont.)

SCORE IMPACT AS MORTGAGE SCENARIO SEVERITY INCREASES

The table below shows the expected point drop or increase to VantageScore credit scores for consumers in Population One (consumers with clean credit files) using the scenarios previously described.

			All trades clean
VantageScore Starting Score			662
Forbearance	Interest only		0
	Reduced principal plus interest		0
	Deferral		-40 to -30
Loan Modification	Principal forgiveness, no partial c/o	Loan is overwritten	10 to 30
		Old loan closed, new loan opened	-14 to -20
	Recapitalization	Loan is overwritten	3 to 15
		Old loan closed, new loan opened	2 to 10
	Recap. and forgive subordinate loans		3 to 10
	Recap. and highly delinquent		
Short Sale			-130 to -120
Foreclosure	Foreclosure initiated		-140 to -130
	Foreclosure initiated; payments still made		-125 to -115
Bankruptcy	Filing only for mortgage trade line		-175 to -165
	All trade lines included in filing		-365 to -355

The impact to a consumer's VantageScore credit score increases as programs reflect more severe restructuring. Loan modification programs have relatively small impacts on consumers' VantageScore credit scores, whereas derogatory events such as short sale, foreclosure, and bankruptcy have much more significant negative impacts. Loan modification ranges are presented for the 10 percent and 30 percent scenario, e.g. a 10 percent recapitalization with an overwritten loan increases the score by 3 points. A 30 percent recapitalization with an overwritten loan increases the score by 15 points.

UNDERLYING DRIVERS FOR RESULTING IMPACT TO VANTAGESCORE CREDIT SCORES

In the above table, the first two forbearance cases have no impact on scores since the consumer is still paying on time (just with reduced monthly payment amount). In the third forbearance case, where no payment is made during the forbearance period, the trade line is temporarily excluded from active trade line calculations. This will lower the consumer's score by 30 to 40 points.

For loan modifications with principal forgiveness, the partial forgiveness of principal will reduce the overall utilization level and help the score if the existing loan is modified, whereas the creation of a new account will reduce the average age of trades on file and have a negative impact on score. In the recapitalization case, the scores are generally higher due to higher credit amounts on open real estate trades. Again, if a new account is created, the positive effect is

RESULTS AND OBSERVATIONS
(Cont.)

partially offset. Similar observations can be seen for recapitalization with forgiveness of subordinate loans.

In the cases of derogatory events (short sale, foreclosure, and bankruptcy), the impact to the score is much more serious. The VantageScore credit score is reduced by 115 to 140 points for short sale and foreclosures, and by 165 to 365 in the event of bankruptcy.

SCORE IMPACT TRENDS FOR CONSUMER PROFILES EXHIBITING INCREASINGLY SEVERE DELINQUENCY

The impact to VantageScore credit scores for consumers with delinquent tradelines on their files (Populations Two, Three and Four) is less than for consumers with all clean tradelines (Population One). Given that the more delinquent populations already have some negative reporting in their credit profile, adding an additional delinquent event will not be as serious as changing from a clean profile to a delinquent profile. As observed, the Short Sale scenario reduces the credit score of the 'all clean' population by 130 to 120 points but only 25 to 15 points for the population who have delinquency on all trades (first mortgage delinquent, other trades delinquent).

		All trades clean	First mortgage clean, other trades delinquent	First mortgage delinquent, other trades clean	First mortgage delinquent, other trades delinquent	First Mortgage 90+dpd
VantageScore Starting Score		862	830	722	625	587
Forbearance	Interest only	0	0	0	0	
	Reduced principal plus interest	0	0	0	0	
	Deferral	-40 to -30	-35 to -25	-10 to 0	0 to 10	
Loan Modification	Forgive, no partial c/o, overwrite	10 to 30	10 to 30	5 to 20	0 to 15	
	Forgive, no partial c/o, new loan	-14 to -20	-10 to -15	-9 to -12	-2 to -5	
	Recapitalization, overwrite	3 to 15	2 to 10	2 to 7	0 to 5	
	Recap., new loan	2 to 10	1 to 5	1 to 5	0 to 3	
	Recap. and forgive subord. loans	8 to 10	3 to 8	5 to 12	12 to 18	
	Recap. and highly delinquent					- 0
Short Sale		-130 to -120	-110 to -100	-50 to -40	-25 to -15	
Foreclosure	Foreclosure initiated	-140 to -130	-130 to -120	-55 to -45	-20 to -10	
	Foreclosure initiated, payment made	-125 to -115	-115 to -105	-40 to -30	-10 to -5	
Bankruptcy	Filing only for mortgage trade line	-175 to -165	-160 to -150	-70 to -60	-30 to -20	
	All trade lines included in filing	-365 to -355	-330 to -320	-220 to -210	-120 to -110	

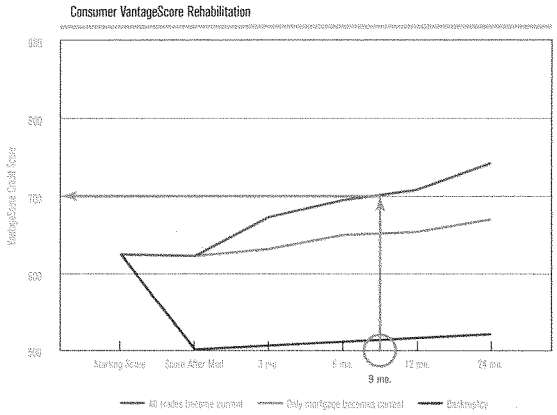
RESULTS AND OBSERVATIONS
(Cont.)

CONSUMER VANTAGESCORE REHABILITATION

Analysis shows that consumers can bring their score to a reasonable credit tier (such that they are potentially eligible for prime credit quality interest rates) if they are able to pay their debts on time after the loan modifications.

Consumers in Population Four (consumers with a delinquent mortgage and at least one other trade whose credit score has fallen to 625) can rehabilitate their score if they bring all debts current and maintain current status for approximately nine months. In that scenario, their score can rise to over 700. (Blue line on the graph). If the consumer brings only their mortgage debt current and maintains that status but other debts remain delinquent, their score could rise to 660, near prime quality after 24 months. (Green line on the graph)

Finally, a derogatory event such as bankruptcy significantly reduces the consumer's score (the red line in the graph below) and further, raising the score is extremely challenging until the public record identifying the bankruptcy filing is removed from the credit file. This is seven years for Chapter 12 and Chapter 13 bankruptcy, 10 years for a Chapter 7 bankruptcy.



RESULTS AND OBSERVATIONS
(Cont.)

NEW LOAN MODIFICATION COMMENT CODES

Historically, loan modifications have been documented on the tradeline with the code 'AC' (see CDIA Guidelines for the Metro 2 format). This code has been used for any loan modification regardless of the nature of the restructuring event. In November, 2009, CDIA announced that the comment codes used to identify loan modification events is expanded and refined to allow lenders to document modifications with greater clarity. The following code is now available:

Special Comment Code CN:

Text: "Loan modified under a federal government plan"

Description: The Special Comment Code is designed to be used for Mortgage accounts that have been modified under one of the federal government loan modification plans.

As statistically adequate volumes of these events are observed in consumer trade files along with the commensurate performance period, VantageScore Solutions LLC will determine the optimal method for utilizing these data to provide analysis to the industry.

CONCLUSION

Housing loans were the epicenter of the national economic crisis. Millions of American families are considering loan restructuring options from a mix of public and private efforts with a goal of saving their homes. Both traditional avenues, such as foreclosure or bankruptcy, as well as new government initiatives such as the Making Home Affordable Program are available to homeowners today. Given the broad reach of the crisis and newly introduced loan modification programs, it is important for consumers, lenders, government leaders and counselors to find the best immediate and long-term solution for these consumers. One factor to consider is the effect that various restructuring options have on consumers' credit scores. This paper addresses both the short term impact to consumers' scores from these various options and then provides a longer term perspective on scores in an effort to highlight the steps consumers can take both during and immediately following a restructuring event to rehabilitate their score should they see a drop.

Clearly, the greatest impact to a consumer score is driven by increasing delinquency rather than changes to the consumer's mortgage trade from a mortgage loan modification. Therefore consumers should proactively work with lenders as early as possible to address potential mortgage payment issues in order to avoid serious deterioration in their score generated from the reporting of several late payments to their credit file. It is no surprise that bankruptcy remains as causing the most severe and longest lasting negative impact on a consumer's credit score. One strategy that consumers can employ to more quickly rehabilitate their score after a severe delinquency is to restructure their mortgage loan in such a fashion to allow them sufficient monthly cash flow to bring other delinquent debts to paid status as quickly as possible.

Finally, as new data fields and comment codes are added to the Metro 2 reporting format, a repeat of this study will need to be conducted to determine the effect of those new elements on a consumer credit score. Such research will be initiated when there is enough evidence of these loan modifications and ensuing consumer behavior in consumer credit files to produce a meaningful result.

APPENDIX II

2008 VantageScore Revalidation

February 2009

VANTAGESCORE.

The New Standard in Credit Scoring

Overview

VantageScore Solutions LLC has conducted its annual revalidation of the credit risk score, VantageScore.

For the third consecutive year, the results of the revalidation show that VantageScore is highly predictive, consistent and has remained highly predictive despite the economic volatility seen in the U.S since 2007.

This paper provides an overview of credit risk score revalidation processes and the primary metrics for determining the quality of a credit risk score. VantageScore revalidation results for the 2006 to 2008 timeframe are also presented.

Background

Credit risk scores play an integral role in today's bank lending processes. Scores are used to identify the likelihood that a consumer will repay a loan. Stated another way, a score with strong predictive power will effectively identify and separate good (likely to pay) consumers from those consumers that are unlikely to pay. This information contributes to the banks' strategies for the type of loan to offer, loan pricing and terms, and the ongoing management of the consumers' accounts.

A credit risk score synthesizes a consumers' prior debt management behavior to estimate how they will manage the repayment of debts in the next two years. An underlying assumption in the design of all score algorithms is that the economic environment remains generally similar to the history on which the score was designed. Scores that have been architected in more recent timeframes like VantageScore will therefore reflect more relevant underlying drivers and behaviors of current economic conditions, and consequently maintain greater predictive power.

Validation routines are run at the time of score development to assess the score's predictive power. Score revalidation analyses are run at subsequent intervals to insure the score retains its predictive power. If the predictive power falls substantially, observed by a significant reduction in statistical predictiveness or a failure to rank consumers according to increasing risk, then the score could expose the lending institution to increased and unnecessary risk.

Given the underlying design assumption presented above, recent economic turbulence and its impact on consumers may result in significant deterioration in credit risk score predictiveness. Score revalidation and monitoring processes are therefore essential to ensuring credit risk scores retain their predictiveness and aid risk mitigation within lending strategies. Lenders should also validate score predictiveness on their own portfolios to ensure the score addresses any nuances within their specific consumer base.

A key mission of VantageScore Solutions, LLC is to validate VantageScore on an annual basis and publish the results to the industry to facilitate understanding of VantageScore predictiveness as well as foster an awareness of credit risk score performance in general.

Revalidation Process

With the recent economic turbulence, an annual revalidation of a credit risk score is critical. In terms of the demographic configuration, size of the sample and the same seasonal timeframe, data selected for the revalidation should be reflective of the data used at time of development.

VantageScore was developed using a June 2003 – June 2005 timeframe on an anonymized sample of 7.5 million consumers, representing the entire U.S. demographic composition. For purposes of the annual revalidation, a similar number of consumers are randomly selected from the three national consumer reporting companies' (CRC – Equifax, Experian and TransUnion) databases over the most recently available two-year window. For the 2008 revalidation of VantageScore, the sample timeframe for revalidation is June 2006 to June 2008.

Many measurements exist to evaluate the performance of a credit risk score on a variety of dimensions. Primary measurements used in the industry are:

- Statistical Validation – Kolmogorov-Smirnov (KS) test or GINI Index. The higher the value of either metric, the more effectively the score predicts consumer repayment performance. (The KS statistic is cited in this paper). Typical commercial credit risk scores have KS statistics in the range of 45 to 70.

- Rank Ordering – Consumers are ranked using the score such that increasing levels of default likelihood are observed in the higher deciles. An effective credit risk score ranks consumer risk such that the risk rate should monotonically increase for each increasing decile. Risk rates that do not monotonically increase are an indication that the score is

failing to rank correctly, in other words, consumers with high risk profiles could be assigned to low risk lending strategies.

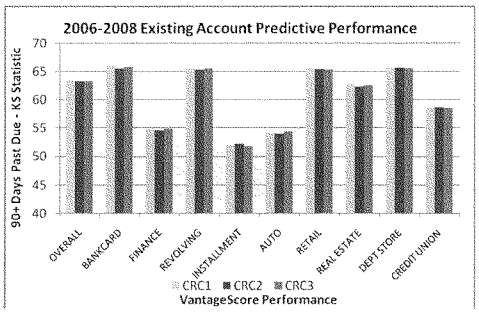
- Score Consistency across CRCs. Using a consistent data set and the same scoring algorithm a consumer should receive identical credit risk scores from multiple CRCs. VantageScore uses the same algorithm at each CRC, furthermore the characteristics used by the algorithm are leveled such that data submitted by lending institutions is interpreted in a highly consistent fashion. Differences in a consumer's VantageScore are driven by variations in the consumer credit file that might exist at each CRC. Those variations are largely driven by two reasons: not all lenders submit customer payment information to all CRCs and payment information may be submitted at different timeframes.

- Score Reliability. Implementation of strategies requires significant resources so lenders require that credit risk scores maintain strong, stable performance over extended timeframes regardless of changes in economic conditions.

VantageScore Validation Results For the June 2006 to June 2008 Timeframe

Statistical Validation

The chart below demonstrates VantageScore is highly predictive. KS statistics are provided for VantageScore when validated at each CRC. Strong scores typically achieve a KS value in the range of 45 to 70.



Rank Ordering

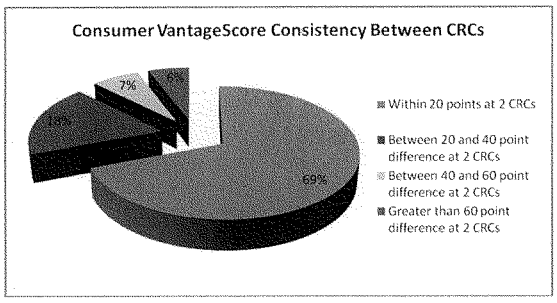
VantageScore demonstrates strong rank ordering functionality, seen in the table below with interval risk rates that are monotonically increasing as the deciles increase. This ensures higher risk consumers are identified and assigned to higher deciles for more conservative lending practices.

	90+dpd Rates	
	Account Mgmt Rates	
Decile	Interval	Cumulative
1	0.14%	0.14%
2	0.19%	0.16%
3	0.30%	0.21%
4	0.57%	0.30%
5	1.16%	0.47%
6	2.41%	0.80%
7	4.81%	1.37%
8	9.34%	2.37%
9	18.05%	4.11%
10	39.64%	7.66%

Consumer Score Consistency

VantageScore continues to demonstrate very strong consumer consistency. Consumers were simultaneously scored at each of the three national CRCs and then analysis was conducted comparing two of the three results. Sixty-nine percent of these consumers received a VantageScore within 20 points of each other. In other words, the consumer's risk threshold is the same from two independent sources. This result is especially important for the real estate industry, where lenders typically require a credit risk score from at least two CRCs. Large variations in the score can result in sub-optimal product and pricing offers for the consumer. The analysis was repeated using all pairwise combinations of data sourced from the three CRCs. Similar results were obtained for each combination.

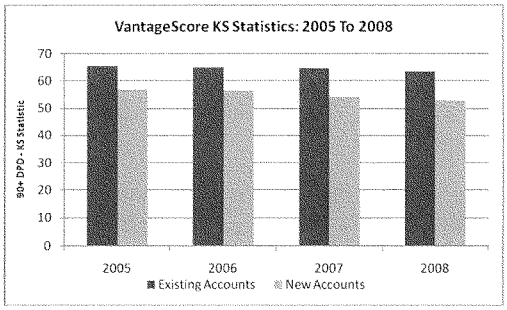
Using the Score Consistency Index (see prior paper from VantageScore, *Score Consistency Index,* April, 2008), VantageScore is typically at least 30% more consistent than other comparable CRC proprietary generic credit risk scores, thereby enabling lenders to make more appropriate product and pricing offers to consumers.



Additionally, score consistency has remained stable over the last four annual validations.

Score Reliability

Four annual validations have been conducted on VantageScore since its development in 2005. The graph below shows the KS statistics for Existing and New account validations for each year. The predictive power of the score has remained extremely strong despite the economic volatility.



Conclusion

Robust revalidation processes are especially critical in periods of economic volatility. The transparency delivered to the market by publishing revalidation results provide the market with an effective tool for understanding risk model performance and stability. The analytics presented above clearly demonstrate VantageScore's ability to deliver consistent performance despite changes in economic conditions.

All lenders who utilize consumer credit risk scores need to be assessing their models' efficacy on an annual basis with measurements similar to the tests provided in this paper. Any significant shifts in score performance could require a corresponding shift in strategy.

VantageScore is a generic credit risk scoring model introduced to meet the market demands for a highly predictive consumer score. Developed as a joint venture among the three major credit reporting companies (CRCs) – Equifax, Experian and TransUnion, VantageScore offers more consistency across all three CRCs and has the ability to score a broad population.

PREPARED STATEMENT OF

ANNE P. FORTNEY
HUDSON COOK, LLP

Keeping Score on Credit Scores:
An Overview of Credit Scores, Credit Reports and Their Impact on Consumers

Before the

SUBCOMMITTEE
ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
HOUSE COMMITTEE ON FINANCIAL SERVICES

Washington, DC

Wednesday, March 24, 2010

Chairman Gutierrez, Ranking Member Hensarling, and members of the Subcommittee, I am Anne Fortney. I am a partner in the Washington, DC office of the Hudson Cook law firm. My practice concentrates on compliance issues under the federal and state consumer protection laws, primarily for the consumer financial services industry. I appreciate the opportunity to appear before you to discuss this overview of credit scores, credit reports and their impact on consumers.

Background and Experience

My first experience in consumer financial services was with the Washington, DC legal office of the JC Penney Company in the late 70's and early 80's – a time when Penney was one of the largest credit card issuers in the country. My principal responsibilities involved legislative and regulatory issues affecting Penney's credit card operations.

My introduction to credit scoring came in 1977. The Equal Credit Opportunity Act (ECOA) amendments were just going into effect, and companies like Fair Isaac were offering credit scoring as a means to assure compliance with this law and enable creditors to underwrite more effectively and price for relative risk. My work included interfacing with Fair Isaac representatives as that company persuaded some very skeptical, experienced consumer credit managers that an empirically derived statistical model could predict risk more consistently and accurately than they could. An important issue, which was also the subject of Congressional hearings, involved the ECOA requirement for a creditor to give reasons for adverse action based on a credit score. Fair Isaac and other credit score developers argued that, in a credit scoring system, the credit score was the only accurate reason for adverse action: If a consumer's score was below the score that

corresponded to the creditor's acceptable level of risk, the consumer would be denied credit. Neither Congress nor the Federal Reserve Board staff was persuaded by that argument, and the ECOA rules required creditors to select the four principal factors used in a credit scoring system that contributed to a consumer failing to achieve the necessary score.

My next exposure to credit scores was at the Federal Trade Commission ("FTC"), where I directed the Division of Credit Practices, beginning in 1982. My responsibilities included ECOA enforcement as to creditors under the FTC's jurisdiction. Creditors' wide-spread use of credit scoring greatly facilitated the government's law enforcement efforts because we could evaluate the legality of criteria that creditors actually applied, rather than have to divine the process based on more general guidelines in a judgmental credit underwriting system.

Since the time that I left the FTC and began private practice with a law firm, my work has focused on consumer financial services, particularly involving the Fair Credit Reporting Act (FCRA), the ECOA and other privacy laws.

Nature of Credit Scoring

Credit scoring is a "statistical technology that quantifies the credit risk posed by a prospective or current borrower."[1] Creditors use this technology to evaluate credit applications, identify prospective borrowers and manage existing credit accounts.[2] Credit scores may also be used as a factor in insurance underwriting.

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[1] Board of Governors of the Federal Reserve System, *Report to Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit*, August 2007 ("FRB *Report to Congress*

In looking at credit scores, it is important to recognize that there are many types of credit scores and many providers of those scores. The Fair Isaac FICO score is perhaps the most recognized, but the Vantage score also has wide distribution. When consumer reporting agencies apply credit scores based on credit report histories, they do so based on scores from a number of credit score developers. Creditors specify which credit score they want delivered with a credit report. Credit scores may also be calculated by mortgage reporting companies that compile consumers' credit reports from each of the national consumer reporting agencies and then deliver the combined reports and scores to a lender. In addition, many large creditors, such as bank credit card issuers and auto finance companies, have developed propriety scores that are most useful in evaluating their particular types of customers. Credit score providers and many of their users continually re-evaluate and update the scoring models based on new information and changes in the marketplace and in consumers' behavior.

Value of Credit Scoring

Based on my experience, I believe that credit scoring delivered on the score developers' promises in the 1970's of a predictive tool that would assure objectivity and legal compliance in credit underwriting decisions. As a result, in the approximately 35 years since its widespread introduction, credit scoring has become an essential tool for creditors, and has also been proven to be a valuable tool in property and causalty insurance underwriting. At the same time, credit scoring models have become

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on Credit Scoring"), available at https://www.federalreserve.gov/boarddocs/rptcongress/creditscore/creditscore.pdf.

[2] *Id.*

significantly more sophisticated in terms of the data analyzed and the predictive quality. In my work with creditors during this time, I have been consistently impressed at the complexity and value of these systems. Because credit scoring has enabled creditors to price effectively for risk, more consumers have been able to obtain and use credit, and at a significantly lower cost. Thirty-five years ago, bank-issued credit cards were reserved for the more well-to-do customers. Today, they are in almost everyone's wallet. Risk-based pricing, based on credit scoring, made this result possible. Credit scoring also plays a significant role in mortgage lending and auto finance.

Because credit scoring systems play such an important role in credit underwriting, they have a significant impact on consumers' access to credit and the price of credit. For these reasons, it is appropriate that such systems be subject to review for fairness, fair lending, accuracy and predictably, among other issues.

Fairness

Based on my experience, I believe it is beyond question that credit scoring is an objectively fair underwriting tool. These systems eliminate the potential biases, illegal or even benign, that may exist in judgmental credit underwriting systems. They ensure that each consumer will be evaluated only according to attributes that are facially neutral. Ironically, it is the fact that credit scoring focuses only on objective factors, such as credit histories and credit usage, that has engendered some of the criticism. For example, some critics complain that credit scores may reflect circumstances beyond a consumer's control (such as a creditor lowering credit limits due to market conditions, or a natural disaster). While these kinds of events may attract new attention, they are not dissimilar to the kinds

of often uncontrollable events that historically have been associated with payment default, such as serious illness, death, divorce or job loss.

In addition, there are proposals to restrict the use of medical debts and student loan default information. These proposals are misguided because they would limit the amount and quality of accurate information in credit report histories.

Regardless of a consumer's personal control over the events leading to default, credit underwriting systems must necessarily focus on the fact of non-payment or default when that is the type of risk they evaluate. This phenomenon is not limited to credit scoring; it is an essential element of credit underwriting. If characteristics such as payment histories or credit limits in credit scoring models were eliminated or restricted regardless of their predictive value, the models would necessarily be less predictive. Les predictive credit scoring models would by definition impair creditors' ability to make sound underwriting decisions or price according to risk. The inevitable result would be less credit availability, at higher prices and/or at prices where good credit risks subsidize the higher credit risks – and none of those results would be more fair than the present systems. In other words, it is neither efficient nor fair to focus on individual circumstances in an underwriting system that is designed to predict risk for an entire population.

Because of our nation's involvement in the conflicts in Iraq and Afghanistan, there is renewed attention to the personal sacrifices of our military personnel, and the effects of deployment on the personal lives and financial affairs of military servicemembers and their families. As the wife and daughter of career military officers, know first-hand the effects of these deployments, particularly on families. I also know

first-hand the strength of the military communities, especially the private volunteer relief societies that help servicemembers solve emergency financial problems.[3] In addition, the Servicemembers Civil Relief Act accords certain protections and rights to individuals who are either on active military duty or recently retired.[4] The purpose of the SCRA is to allow the servicemembers to perform their valuable duties without the worry of civil prosecution, repossession, foreclosure or eviction under most circumstances. If these protections are insufficient to help an individual member of the armed services when faced with financial difficulty, the solution is not to prohibit creditors from furnishing accurate but negative information about the servicemember's credit payment performance to consumer reporting agencies. In fact, the suppression of this information would harm all servicemembers because it would make suspect the accuracy and completeness of their credit report histories. This is an example of how the suppression of accurate credit report information would harm the population it is designed to protect.

Finally, I have heard the complaint that credit scoring models may penalize consumers who are conservative in their use of credit or who, because of age or other circumstances, may have limited credit histories. If this allegation is true, the obvious solution is to increase the amount of information available to credit score developers. Without credit histories and similar empirical information, creditors are unable to assess the relative risk of a consumer's default. By analogy, a 16 year-old has a perfect driving record when she obtains her first driver's permit.

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[3] There are four private, nonprofit societies serving servicemembers and their families: Army Emergency Relief, Air Force Aid Society, Navy-Marine Corps Relief Society and Coast Guard Mutual Assistance. Each has local representatives on military installations, usually in family centers.

[4] The SCRA, 50 App. U.S.C.A. §§ 501 *et seq.*, is the successor to the Soldiers and Sailors Relief Act. *See* http://www.servicememberscivilreliefact.com.

Fair Lending

It is significant that in the last 30 years, fair lending cases brought by the FTC and the Department of Justice have not involved credit scoring. Instead, in the vast majority of those cases, as well as in private litigation, the focus has been on "discretionary pricing," where mortgage originators or auto dealers are alleged to have increased the cost of credit for minorities without regard to risk. In fact, in the auto finance litigation, consumers alleged that the "buy rates" at which the auto finance companies or banks offered to purchase dealer retail installment sales contracts were risk-based but that the dealers' mark-ups were based on non-risk related criteria and resulted in a disparate impact for African Americans and other minorities.[5] In other words, the complaint was that, as lenders allowed pricing that was not based on credit scoring models and similar risk assessment, the resulting pricing adversely affected African Americans and other minorities. Because the consumer credit industry has so long relied on credit scoring as a means of fair lending compliance, the value of these systems in assuring fair access to credit may be overlooked or taken for granted.

Because credit scoring is an effective tool for creditors' compliance with the fair lending laws, it is ironic that credit scoring models have been attacked on the basis that they may have an adverse effect on minorities and other protected groups. In response to such criticisms, Congress directed the Federal Reserve Board to study credit scoring and also directed the FTC to study the use of credit scores in property and casualty insurance

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[5] *See, e.g.,* Cason v. Nissan Motors Acceptance Corp., No. 3-98-0223 (M.D. Tenn., filed April 29, 1998); Claybrook et al. v. Primus Automotive Financial Services, Inc., No. 02-CV-382, (M.D.Tenn., filed Apr. 16, 2002); Coleman v. General Motors Acceptance Corp., No. 3-98-0211 (M.D.Tenn., filed April 29, 1998); Jones v. Ford Motor Credit Co., No. 00-CIV-8330 (S.D.N.Y., filed Nov. 2, 2000); Osborne v. AmSouth Bankcorp., No. 02-CV-577 (M.D.Tenn., filed Jun. 18, 2002); Osborne v. Bank of America N.A., No. 02-CV-364, (M.D.Tenn., filed Apr. 12, 2002).

underwriting. Both of those studies demonstrated the predictive value of credit scoring and their benefit to consumers regardless of race, ethnicity, or gender.[6] The Federal Reserve Board reported that "credit characteristics included in credit history scoring models do not serve as substitutes, or proxies, for race, ethnicity, or sex."[7] The Board found that certain credit characteristics serve, in part, as limited proxies for age. As a result, credit scores for older individuals are slightly lower, and those of younger individuals somewhat higher, than would be the case had these credit characteristics not been partial proxies for age. However, the Board also reported that "mitigating this effect by dropping these credit characteristics from the model would come at a cost, as these credit characteristics have strong predictive power over and above their role as age proxies."[8] In other words, while there may be some limited impact on consumers based on age, that impact is off-set by the predictive value of the credit score models.

The Federal Reserve Board study also found that different demographic groups had substantially different credit scores, on average. "For example, on average, blacks and Hispanics have lower credit scores than non-Hispanic whites and Asians, and individuals younger than age 30 have lower credit scores than older individuals. Also, for given credit scores, credit outcomes—including measures of loan performance, availability, and affordability—differ for different demographic groups."[9]

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[6] FRB *Report to Congress on Credit Scoring*; Federal Trade Commission, Report to Congress: *Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance* (July 2007), ("FTC Report on Credit-Based Insurance Scores"), available at http://www.ftc.gov/os/2007/07/P044804FACTA_Report_Credit-Based_Insurance_Scores.pdf.
[7] FRB *Report to Congress on Credit Scoring* , p. S1Ss2.
[8] *Id.* at S-2.
[9] *Id.*

At the direction of Congress, the FTC conducted a study of the use of credit scores in automobile insurance.[10] The FTC's study found that credit-based insurance scores are effective predictors of risk in automobile policies and that they may benefit consumers through lower premiums and wider availability.[11] The FTC also found that credit-based insurance scores have only a small effect as a "proxy" for membership in racial and ethnic groups in estimating insurance risk, while they remain strong predictors of risk when controls for race, ethnicity and income are included in risk models. The FTC was unable to develop an alternative credit-based insurance scoring model that would continue to predict risk effectively, yet decrease the differences in scores on average among racial and ethnic groups.[12]

These results are consistent with my experience while serving at the FTC and in working with creditors. Characteristics that correlate to lower credit scores (such as credit payment histories, available credit, wealth, employment, and education) are unevenly distributed across demographic groups and may also correlate to race, ethnicity and other protected characteristics. However, this phenomenon is reflected in credit underwriting in general. The solution is to increase educational and employment opportunities for underserved populations and to provide for alternative sources of data that may predict creditworthiness, such as rent, utility and telecom payments. In other words, the solution is to increase opportunities and available data, which in turn should or could raise credit scores for these underserved groups.

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[10] FTC Report on Credit-Based Insurance Scores.
[11] *Id.* at 3.
[12] *Id.* at 4.

Accuracy and Predictability

Criticism of credit scoring's accuracy and predictability is not new. I recall the arguments of the credit managers as they resisted the introduction of credit scoring in the late 70's. To alleviate these concerns, creditors often instituted judgmental over-rides in credit decisioning, where credit analysts were able to second-guess the credit scoring results. Those over-ride systems were found to be less accurate and predictable than credit scoring outcomes and in time were eliminated.

The 2007 Federal Reserve Board Report on Credit Scoring confirmed the early impressions of the effectiveness of credit scoring, finding that credit history scores "are predictive of credit risk for the population as a whole and for all major demographic groups. That is, over any credit score range, the higher (better) the credit score, the lower the observed incidence of default. . . ." Evidence provided by commenters, previous research, and the present analysis supports the conclusion that credit has become more available over the past quarter-century. Credit scoring, as a cost- and time-saving technology that became a central element of credit underwriting during that period, likely has contributed to improved credit availability and affordability."[13]

Today, concerns regarding the accuracy and predictability have a new criticism: If creditors lower credit limits and lines of credit in open-end credit in response to safety and soundness concerns and market conditions, the affected consumers' credit scores will decline, even if their credit payment histories or credit usage remains unchanged.

There are several responses to this criticism. First, particularly in the area of credit card accounts, many consumers had their credit limits raised when the economy

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[13] FRB, *Report to the Congress on Credit Scoring* at S-1.

appeared to be going well. Creditors' lowering of credit limits may simply reflect widespread awareness that these high credit limits are no longer consistent with current economic conditions. If that is the case, one would expect minimal impact on the affected consumers' credit scores.

More recently, there have been media stories that borrowers participating in government assisted mortgage modification programs may experience credit score declines. These stories overlook the fact that the borrower is seeking a modification because the borrower cannot sustain the current mortgage payments. A borrower in that situation may present an increased risk of default because debt to income ratios may be excessive. In fact, the media stories profile consumers who entered into these mortgage modification programs because they were experiencing difficulty meeting all their credit obligations, often due to a job loss or a new job at a significantly lower income than their previous employment.[14] Because these consumers present an imminent risk of default, they are a greater credit risk. When a credit scoring model lowers their credit scores, it may be revising their credit profiles to reflect their current level of risk.

However, to the extent that any lower scores may not reflect consumers' real risk, credit scoring systems should address these anomalies as the systems are periodically reevaluated and updated. Credit scores are never static, and a temporary depression in a consumer's score should be corrected by changes to credit scoring models and the passage of time. Moreover, creditors would undoubtedly report to credit score providers any declines in the predictability and reliability of credit scoring models. This kind of

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[14] *See e.g.,* http://finance.yahoo.com/news/Credit-scores-can-drop-after-apf-1601705094.html?x=0.

feedback and the competition among score developers will address anomalies in the systems far better than any external interference. At the end of the day, credit score developers and the users of credit scores are in the best position to evaluate the accuracy and predictability of credit scores because of their impact on the bottom line.

Consumer Protection

I believe a lot of concerns about credit scoring stem from a perceived lack of transparency – while consumers may understand the effect of credit scores on their lives, they may not understand how credit scoring works. As a result, they may feel that their lives are affected by a system that is beyond their control. In reality, however, there are important ways in which consumers can become more informed about credit scores and use that knowledge to their advantage.

First, there are important rights and remedies for consumers with respect to credit scores. There are numerous laws and regulations designed to ensure that consumers understand that credit scores are used in the decision process and what they should do if they believe that information might be inaccurate.

Early Notice: In the near future, consumers will be entitled to notices under the Fair Credit Reporting Risk-Based Pricing Regulations.[15] A consumer who receives a risk-based pricing notice will have the right to obtain a free copy of his or her consumer report. As an alternative to the risk-based pricing notice, creditors may also give a credit score disclosure notice to consumers. This credit score disclosure notice will explain to consumers how their credit scores compare to other consumers. The risk-based pricing

[15] 16 CFR Part 640; 12 CFR Part 222, Subpart H.

notice and credit score disclosure notice give consumers a valuable opportunity to understand that credit scores are being used, where the consumer might fall in relation to others, and alert the consumer to the possibility of inaccuracies in his or her consumer report. The risk-based pricing and credit score disclosure notices will put consumers in a position to take action to cure any inaccuracies and obtain credit on the best terms under the circumstances.

Early Notice for Home Loan Applicants: Consumers applying for loans secured by residential real property already receive a notice required under the FCRA -- "Notice to the Home Loan Applicant."[16] The Notice to Home Loan Applicant has always included the credit scores and the key factors affecting the score. Now, the notice may include additional information as a result of the risk-based pricing regulations because creditors may add information to the notice that explains how a consumer compares to other consumers.

When consumers understand how they compare in relation to other customers of the creditor or consumers in the marketplace, they will have a better understanding of the credit terms they receive.

Notice After Denial or Adverse Change: The ECOA and Regulation B require a creditor to send a written adverse action notice to an applicant within 30 days after taking adverse action on a completed application or taking adverse action on an existing account.[17] When a creditor relies on information from one of the consumer reporting

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[16] FCRA § 609(g).

[17] 12 CFR § 202.9(a)(1)-(2). Adverse action covers situations when a consumer did not receive credit on the terms requested, when a consumer's account was terminated or terms change in an unfavorable way, or when a consumer was denied a request for an increase in the amount of credit available. 12 CFR 202.2(c)(1).

agencies to take adverse action, the creditor has additional notice obligations under the FCRA. The FCRA notice informs the consumer that the user's decision was based on information in a consumer report, the name of the company that provided the report, and a statement that the consumer has the right to obtain a free copy of the report and dispute any information that might be inaccurate.[18]

When consumers receive notices under the ECOA and/or the FCRA, the consumer will learn that there may be negative information in their credit reports. The consumers will have the opportunity to obtain their credit report and to correct any inaccurate information. This process gives consumers another opportunity to monitor the information that is included in their files at the consumer reporting agencies.

When the Consumer Obtains a Report: Today, consumers have easy access to their credit reports. If a consumer believes that information in his or her credit report is inaccurate, the consumer can dispute the information in two ways: (1) through the consumer reporting agency and (2) directly with the person who furnished the information. The remedies are not mutually exclusive.[19] The consumer's ability to dispute information through two channels provides the consumer with an even greater ability to understand what is being reported and to ensure that the information being reported about the consumer is accurate.

Changes to Terms of a Credit Card: The new CARD Act rules generally prohibit increasing rates on accounts, except under certain limited exceptions, including

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[18] FCRA § 603(k)(1)(A) and (B)(iv); FCRA § 615(a). This FCRA notice requirement also applies to consumers in the insurance context. Under the FCRA, adverse action also includes cancellation or denial of insurance coverage, an increase in rates, a reduction or other unfavorable change in coverage or the amount of insurance. If an insurer takes any of these actions, then the insurance must send the same FCRA notice a creditor would be required to send.
[19] FCRA § 615(a).

with advance notice. The FRB proposed rules to implement provisions of the Act that become effective on August 22, 2010 will also impose notice requirements designed to help the consumer understand the reasons for the change. The proposed CARD Act rule includes examples of information that a consumer might receive: If a notice of a rate increase is triggered by a decrease in the consumer's credit score, the card issuer may tell the consumer that the increase is due to a decline in creditworthiness or a decline in the credit score. Limitations and notices under the CARD Act rules should ensure that consumers have a better understanding of the nature of and reason for the changes being imposed.

Second, consumers have important educational opportunities regarding their credit scores. The FTC has issued an informative Facts for Consumers, "Need Credit or Insurance? Your Credit Score Helps Determine What You'll Pay."[20] Consumers can also learn about credit scoring through websites such as myFICO.com, and from consumer reporting agencies on their websites. Much of the information is free, and consumers can apply that information to their own credit reports for a nominal fee.

Based on my consumer protection experience at the FTC, I firmly believe that consumer education plays a large role in consumers' abilities to protect themselves and secure their financial futures. At the same time, I do not believe that consumer reporting agencies or other providers of credit scores should be required to give away their product for free. Proponents of this view share a fundamental misunderstanding with those that criticize the educational credit scores that Experian or others may provide to consumers on their website. They persist in the mistaken belief that there is only one credit score,

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[20] http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre24.shtm

and that Fair Isaac is the provider of that score. In fact, as discussed above, there are many credit scores provided by many different sources. Moreover, it would be fundamentally unfair to require any credit score provider, such as a consumer reporting agency, to give away credit scores. The important information for consumers is how their credit report affects their credit scores and what steps they can take to improve their credit histories. That information is currently available, and federally-mandated disclosures such as adverse action notices and risk-based pricing notices should improve consumers' awareness of their credit scores and access to this educational information.

Conclusion

Credit scoring has been widely adopted as an effective tool in credit and insurance underwriting. It enables creditors and insurers to predict accurately the risk associated with a consumer's application for credit or insurance. Because credit scoring models are devoid of characteristics with respect to race, gender or other prohibited factors, credit scoring facilitates fair lending compliance and assures treatment based on objective criteria. Many concerns about credit scoring can be attributed to a lack of transparency and a lack of understanding about the factors applied in credit scoring. These concerns can be addressed through the implementation of required notices and increased consumer education and awareness of the process.

Thank you for the opportunity to testify. I will be glad to answer your questions.

SUBCOMMITEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT
OF THE
HOUSE COMMITTEE ON FINANCIAL SERVICES

HEARING ON
"Keeping Score on Credit Scores: An Overview of Credit Scores, Credit Reports and Their Impact on Consumers"

March 24, 2010

Testimony of:

Myra Hart, PhD
Senior Vice President, Analytical Services
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1555 Peachtree Street, NW
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INTRODUCTION

Chairman Gutierrez and members of the Subcommittee, I am Myra Hart, Senior Vice President of Analytical Services for Equifax Inc. I want to thank you for this opportunity to testify regarding credit scores and their impact on consumers. I would also like to express my appreciation to your staff for all their assistance in preparing for this hearing.

This statement briefly describes Equifax Inc.; describes what a credit score is; discusses benefits credit scoring provides to both consumers and lenders; and discusses Equifax's credit scoring models and scores. 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.

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. 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. 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 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/statistically based 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

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

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 SCORES TO CONSUMERS AND LENDERS

Credit scoring systems provide benefits for consumers, for lenders, and for the economy. According to 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 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.
- Credit scoring has promoted competition between lenders by making it possible for creditors to readily solicit business from their competitors.

CREDIT SCORES OFFERED BY EQUIFAX

Equifax markets third-party credit scores, such as the VantageScore, of which Equifax shares partial ownership.[3] Equifax also has developed scoring models of its own, such as the Equifax Risk Score[sm]. Equifax Risk Score is a general purpose risk model that predicts the likelihood of a consumer being seriously delinquent.[4] Also, as noted above, many customers choose to develop their own scoring models and then obtain 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 has developed hundreds of customized credit models for use by its customers. These models pivot off of criteria, metrics, and goals provided to Equifax by our customers. Equifax credit scores predict the likelihood of a particular behavior by a consumer, 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.

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[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.

[3] VantageScore is an alternative to the FICO score created by Equifax, Experian, and TransUnion.

[4] "Seriously delinquent" is defined as 90 days past due, including charge-off, repossession, foreclosure, bankruptcy and other major derogatory events.

Equifax credit scores are mathematically and statistically-derived and correlated to actual historical behavior or performance. Scores 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,[5] which implements the Equal Credit Opportunity Act,[6] 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 credit scoring models typically assign higher scores to consumers who exhibit a high likelihood of exhibiting the consumer behavior the credit scoring model is developed to predict. For example, with a credit scoring model developed to predict the likelihood of a consumer paying the account as agreed, a high credit score indicates a high likelihood of satisfactory repayment performance, i.e. the consumer paying the account as agreed. Conversely, lower credit scores would indicate a likelihood of low or unsatisfactory performance. Our scores potentially are based on hundreds of discrete factual items of information in the credit file, which can be broadly grouped into categories, commonly referred to as "attributes", such as payment history, amounts owed, length of credit history, new credit account activity, and the types of credit used (installment, revolving, etc.). Equifax does not use information about gender, race, color, national origin, marital status, religion, or address as attributes in its credit scoring models.

The weighting of particular attributes varies from model to model depending upon the customer's (user's) goals and how that attribute impacts the type of behavior or outcome that the scoring model is seeking to predict. Equifax offers both custom and generic credit scoring models. A "generic" credit score is derived from a scoring model that has been developed 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 credit scores are based on information in a consumer's Equifax credit file, which is subject to the full range of standards, rights, and protections, afforded by the FCRA. Information used in scoring Equifax credit 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); certain inquiry information; and public record or collection information such as certain judgments, tax liens, bankruptcies and third-party collection account information. For the Equifax Risk Score, 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. Credit reports also include identifying information about consumers, but this information is not used as attributes in a credit scoring model.

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[5] 12 C.F.R. Part 202.
[6] 15 U.S.C. Sec. 1691 *et. seq.*

Information that may be predictive of creditworthiness, other than the information 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. Legal and other barriers create challenges for collecting this information. The use of such information (once collected and reported in traditional credit files) in credit scoring models, based on traditional credit files, would require continuing study, looking both at its content and its impact on current, traditional credit scores. Equifax already provides some types of alternative data as a service provider to many telecommunications and utility companies, and Equifax is committed to developing additional sources of alternative data so as to assist further in "thin-file" and "un-banked" consumers.

CONCLUSION

Thank you again for the opportunity to testify on these important issues. The advent, proliferation, and popularity of automated decision-making through credit scores has had a profound and comprehensive impact on the credit process. Making credit decisions using credit scores has made the process faster, more objective, and based on consumer merits (i.e. a repayment record that the consumer has earned). Increased efficiency in the credit process allows for increased accessibility to credit for low and middle income and minority populations. Credit scores are an effective, usable risk management tool for financial institutions to improve the safety and soundness of their lending practices, which benefits consumers, lenders, and the economy. 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.

BIOGRAPHY

Myra Hart currently holds the position of Senior Vice President for Analytical Services at Equifax, where she manages Analytical Consulting and is responsible for designing and delivering decisioning solutions that span the customer lifecycle for financial services, telecommunications, retail and insurance clients. After completing a PhD in Economics at the University of Iowa, Myra began her career as an Assistant Professor of Economics at Whittier College. Since then, Myra has built more than 15 years of experience in customer segmentation, scorecard development and implementation, database marketing, credit strategy and policy and econometric analysis while holding positions of increasing responsibility at First Chicago Bank, Bank One/First USA and Equifax.

PRIVACY TIMES

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

Before The House Financial Services Committee
Subcommittee on Financial Institutions & Consumer Credit
March 24, 2010

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 33 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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Testimony

Credit Scores

- Consumers should be entitled to one free credit score per year, and it specifically should be for a credit score that is used by a majority of lenders. (Not a so-called "educational" score.)

- Companies that sell credit scores should **prominently** disclose whether their score is (1) used by any lenders; (2) used by a majority of lenders.

- Congress should prohibit contract language that prevents "resellers" (independent credit bureaus) from selling or disclosing directly to consumers the credit scores or specialized credit reports that they compile in the form of "tri-merge" reports or other reports.

- Consumer reporting agencies (CRAs) should be required to disclose publicly how many credit scores they sell and their gross revenues from those sales.

Consumer Reports & Consumer Reporting Agencies (CRAs)

- Experian, Equifax & TransUnion ("The Big Three" CRAs) naturally want to automate their operations to the greatest extent practicable to reduce costs. However, at times the manner in which they automate contravenes the FCRA's central goals of accuracy and fairness. For example, Experian encourages consumers to go online to its Web site to dispute errors in their credit report. But if they do, it's unlikely that any human being at Experian will evaluate the consumer's dispute, no matter how complex or nuanced it is.

- The Big Three sometimes fail to satisfactorily resolve consumers' legitimate disputes because instead of truly reinvestigating disputes, they electronically notify the creditor of the dispute, and then permit the creditor to dictate the results via the creditor's e-response. This helps explain why we continue to see absurd results, like CRAs and creditors "verifying" that a living consumer is "dead," or that a 22-year-old is responsible for a credit card that was opened 10 years ago.

- In the FCRA, Congress declared, "There is a need to insure that consumer reporting agencies exercise their grave responsibilities with fairness, impartiality, and a respect for the consumer's right to privacy." Yet there have been instances in which CRAs, when confronted with their specific failures to ensure accuracy or correct inaccurate disputed data, have argued that they are like "libraries" that passively receive data from creditors similar to the way in which libraries put books on the shelf without screening them. The reality is that the Big Three see their primary duty to faithfully put on consumers' reports what creditors and debt collectors dictate – even when there is compelling evidence to the contrary (e.g., I'm not dead!).

Inaccuracy

- Consequently, inaccuracy continues to be a significant problem. Some of the leading consequences of chronic inaccuracy continue to be mixed files, identity theft or erroneous furnishing by creditors and debt collectors.

- Inaccuracy problems are reflected in the latest FTC complaint statistics. Two of the leading complaint categories – Identity Theft (278,078, 21%) and Debt Collection (119,549, 9%) – are closely tied to credit reporting inaccuracy. Moreover, 31,629 (2%) Americans complained about credit bureaus and information furnishers, and Report Users 41,448 (3%) complained about credit protection/repair or advance-fee loans. This meant that up to 1/3 of complaints to the FTC potentially related to credit report inaccuracies.[1]

- As Congress is aware, there have been several studies by non-industry groups finding significant rates of inaccuracy.[2] While the CRAs have criticized these studies, it is

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[1] http://www.ftc.gov/opa/2010/02/2009fraud.shtm

[2] See discussion of credit report errors in "Consumer Reporting Reform Act of 1994," Report of the House Committee on Banking, Finance & Urban Affairs, (Rpt. No. 103-486, 103rd Congress, 2nd Session), "Consumer advocates, state law enforcement officials, and federal regulators all testified that the number of errors in consumer reports was unacceptably high and that the process for reinvestigating consumer disputes was lengthy and inefficient. The FTC testified that the number of complaints about the credit reporting industry exceeded the number of any other category of complaints in both 1991 and 1992… " The committee report also cited several studies, starting with (1) James Williams (CIS), "Credit File Errors, A Report," August 7, 1989 -- A survey of 1,500 consumer reports and found serious error rate of 42% to 47%; and (2) Consumers Union, "What Are They Saying About Me? The Results of a Review of 161 Credit Reports From The Three Major Credit Bureaus, April 29, 1991 -- 48% contained "serious errors," defined as meaning those that could, or did, cause the denial of credit, employment or insurance. [I currently do not have copies of these two studies.] The committee report also cited the three U.S. PIRG studies listed below, as well as various consent agreements, discussed below, between the three major credit bureaus and/or the FTC and/or State Attorneys General.

U.S. Public Interest Research Group (US PIRG), "Nightmare On Credit Street (Or How The Credit Bureau Ruined My Life): Case Studies Documenting Consumer Complaints and Recommendation For Amending the FCRA," June 12, 1990.

U.S. Public Interest Research Group (US PIRG), "Don't Call; Don't Write; We Don't Care." 1991 -- Review of 156 consumer report complaints on file at the FTC revealed that the average duration of complaints against a CRA was 22.5 weeks, or almost 6 months

U.S. Public Interest Research Group (US PIRG), "Public Enemy #1 At The FTC " October 1993, Based upon a Freedom of Information Act request, the 1993 report found that between 1990-93, problems with credit bureaus was the leading cause of complaints to the FTC (30,901, 20.6%). The 1993 PIRG found that 44% of complaints concerned mixed files, and that among those, 64% involved the mixing of data with total strangers.

U.S. Public Interest Research Group (US PIRG), "Mistakes Do Happen: Credit Report Errors Mean Consumers Lose," March 1998

absolutely crucial to note that the CRAs themselves have testified that they have not conducted their own accuracy studies – despite the fact that they have all of the data, and despite the FCRA's requirement that they maintain "reasonable procedures for maximum possible accuracy." (The CRAs' trade association did hire Arthur Anderson to do a study in 1992, but it was not well received.)

- Congress recognized this problem in the FACT Act Amendments of 2003, mandating that the FTC conduct accuracy studies. Unfortunately, the FTC's preliminary efforts a few years ago were inadequate in both process and product, at least partly because of the choice of contractors. The FTC currently is about to select a new contractor, but I fear that the effort still lacks the necessary ongoing guidance and expertise, as well as the fundamental understanding that the FCRA is a consumer protection statute and credit report accuracy is first and foremost a consumer protection issue.

Those 'Other CRAs'

- In addition to the Big Three, there are many "specialty" CRAs, specializing in employment background checks, tenants, prescription drugs, retail customers, and utilities. The problem is that we do not know how many. There is no comprehensive list of CRAs. The best list is maintained by the Privacy Rights Clearinghouse. (www.privacyrights.org)

- It is vital that consumers know that CRAs exist so they can see copies of their reports. Accordingly, I recommend that Congress require all CRAs – big and small – to register with the Federal Trade Commission it can publish and update a list of operating CRAs, allowing consumers to know where data on them reside.

- The National Consumer Telecom & Utilities Exchange, Inc. (NCTUE) is a stellar example of the lack of transparency. NCTUE is owned by its members, several major utilities and telecom companies, which NCTUE declined to name when asked by *Privacy Times*. Member utilities and telecoms check applicants against the NCTUE database, which is operated by Equifax, to see if they have unpaid bills. If the check turns up derogatory data, the applicant presumably is rejected or charged a higher deposit or rate. The first problem is that it is not clear whether members were providing "adverse action" notices to consumers so they'd know they were negatively affected by an NCTUE report. The second problem is that *Privacy Times* and others

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"Credit Reports: How Do Potential Lenders See You?" *ConsumerReports.org*, July 2000.

Consumer Federation of America and National Credit Reporting Association, *Credit Score Accuracy and Implications for Consumers*, December 2002.

Robert Avery, Paul Calem, Glenn Canner, and Raphael Bostic, "An Overview of Consumer Data and Credit Reporting," *Federal Reserve Bulletin*, February 2003.

U.S. Public Interest Research Group (US PIRG), "Mistakes Do Happen: A Look at Credit Report Errors," June 2004

were unable to learn how and from whom consumers could request copies of their reports. NCTUE simply declined to answer these questions. (Story attached.)

Employment Background Screening

- We are seeing increasing problems with employment background screening companies, in part, because too many of them are willing to sell a report on a job applicant based merely on a match of a name and date-of-birth. They don't even require a match on the Social Security number or the last four digits of the SSN.

- I have seen cases in which hard-working, law abiding Americans were rejected for jobs because this sloppy matching approach caused them to be associated with the crimes of people with similar names. Frankly, I think this is actionable under the FCRA, but there are few, if any, enforcement actions to point to.

- Given the job market, and the inherent inaccuracies in public records, and the reckless approach taken by too many employment background screening companies, better enforcement of existing laws, and more stringent laws are necessary to protect innocent consumers.

Enforcement

- The FCRA is a good law, but one of its biggest shortcomings was assigning enforcement relating to creditors' "data-furnishing" to the federal banking agencies. In the last 12 years, those agencies have not brought a meaningful enforcement action, despite abundance evidence that too many creditors do not exercise adequate care when furnishing data to credit bureaus. Enforcement should be stripped from those agencies and assigned to entity that will live up to its duty to enforce standards of accuracy and fairness.

- The history of the FCRA underscores the importance of private enforcement in achieving the law's goals of accuracy, fairness and privacy. Although time constraints don't permit it here, my hope is that the Subcommittee could be supplied with the impressive list of consumer lawsuits that have improved protections for consumers and/or caused companies to improve their credit reporting policies and practices.

- The debate has raged for sometime about who "owns" personal data. In fact, current law makes at least some companies the "owners" of personal data they collect in the course of business. But most would agree that the intimate details about our private lives are more than just a commodity. The reality is that in the context of the United States' information-age economy, our personal information is a new type of natural or public resource. Defining it as such would seem to have dramatic implications for public policy. At earlier times in history, the conclusion that electricity, or water, or the airwaves were public resources resulted in the development of new infrastructures for administration and enforcement. Those infrastructures in no way ended the debate

over how the resources were distributed and used, as new controversies arose through the years. Given the importance of credit reporting data to individual Americans and to our economy as a whole, I believe we should keep in mind the need for closer regulation and enforcement.

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.

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.[3]

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."[4]

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 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

[3] One of the first to report on credit scores and their importance was Michelle Singletary of the *Washington Post* in the mid-1990s.
[4] 15 U.S.C. Sect. 1681g(a)(1)

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.[5]

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."[6]

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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[5] E-Loan Opens Over 10,000 Personalized Loan Management Accounts In First Month," E-Loan Press Release, March 23, 2000

[6] 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.[7]

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

[7] 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.[8]
>
> 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

[8] www.experian.com/small_business/knowledge.html, visited 9/14/07.

will be disclosed to the creditor, the first factor considered by the Equifax system is geographic region.

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).[9]

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, [10] (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.

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[9] Testimony of Phyllis Dorman, Matthew Kirkpatrick v. Equifax Credit Information Services, U.S. Dist. Ct., Oregon, CV-02-1197-MO; 1/20/05

[10] 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."

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 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.*]

Conclusion

Again, thank you for the honor and privilege of testifying before the subcommittee. Although the FCRA is one of the best information-privacy laws on the books, the nature of credit scoring and reporting requires ongoing modernization and vigilant enforcement.

I look forward to working with the subcommittee. I am happy to answer your questions.

Story From *Privacy Times*, October 23, 2009

IS LITTLE-KNOWN DATABASE SUBJECT TO FCRA? EQUIFAX, NCTUE WON'T SAY

For several years, several major utilities and telecom companies, with the help of Equifax, have secretly screened prospective customers' applications against a database on non-paying customers, and presumably have rejected applicants or charged higher deposits or rates based upon their profiles. One source estimated that 80 percent of major utilities participate, meaning the little-known database contains data on millions of unsuspecting Americans.

It's called the National Consumer Telecom & Utilities Exchange, Inc. (NCTUE), and several legal experts believe that its shadowy operations, as well as the presumed failure of utilities and phone companies to provide "adverse action" notices, runs afoul of the Fair Credit Reporting Act (FCRA).

Without adverse action notices, consumers would never learn they were being turned down because of their NCTUE file. Thus, they would not know they needed to access their files, check them for accuracy and dispute errors – an all-too-common process in traditional credit reporting.

While testifying about the FACT Act Amendments to the FCRA in 2003, then FTC Commissioner Timothy Muris called "adverse action" notices the "teachable moment" that was at the heart of the FCRA's regime for improving accuracy.

Richard J. Rubin, an attorney who has successfully argued several FCRA cases before federal appeals courts and chair *emeritus* of the National Association of Consumer Advocates, said there was no doubt in his mind that NCTUE was governed by the FCRA.

"These types of customer screening lists – compiled from consumers' past experiences and performance with companies who then share the data with each other – are well established as consumer reports covered by the FCRA. As a result, the compilers of the lists are consumer reporting agencies who, along with the furnishers and users of the information, are each subject to their various responsibilities under this federal law," he said.

It appeared that Equifax was aware the FCRA applied in some manner to the NCTUE. Until October 10th, a page on its Web site, in promoting the benefits of the service, stated, "Receive technical and user support, daily reports, monthly management reports, and a toll-free customer service number for consumer adverse action and resolution as stated by the FCRA guidelines … Comply with FCRA Consumers who have been denied credit or assessed a deposit based on information in the NCTUE database can contact Equifax via a 1-800 customer service number."

But the page apparently was pulled down around October 10th. (It can still be viewed by going to www.bing.com, typing in the phrase, "NCTUE and FCRA." At the second entry,

beginning with the text, "Comply with FCRA," below that sentence, click on "*Cached page*.") (*Privacy Times* sent its first query to Equifax on Oct. 5th.)

On the other hand, one knowledgeable source said that an NCTUE user had indicated that Equifax personnel told him that the database was not subject to the FCRA.

Privacy Times submitted questions to both NCTUE and Equifax as to whether they believed NCTUE was covered by the FCRA, and whether they provided consumers with access to their profiles. We also asked them how many consumers were in their files, how many companies participated and what were the revenues to Equifax and to NCTUE.

NCTUE Executive Director Alan Moore told *Privacy Times* he would refer the questions to the NCTUE Executive Council. Later, he said the council had directed its counsel, Craig L. Cesar to respond.

Neither Equifax nor NCTUE answered any of the specific questions. Instead, Jennifer Costello, an Equifax media spokeswoman, responded with the following joint Equifax-NCTUE statement:

"Thank you for sharing information regarding your upcoming article. We appreciate your interest in the NCTUE, a member-owned database housed and managed by Equifax. NCTUE membership is available to the nation's leading telecommunications and utility companies. The NCTUE database contains proprietary account and contact information from companies that provide utility, telecommunications and cable/satellite services. Equifax maintains this data repository as a separate database, with NCTUE information shared among exchange members. By providing industry-specific data, the NCTUE gives businesses access to a valuable tool that can be used with other data sources to help manage risk across the customer lifecyle. As always, consumer protection is our highest priority and, for this reason, we are committed to the confidentiality and proper use of the consumer's information. For more information about the NCTUE, visit www.nctue.com."

In March 2002, the *Atlanta Business Chronicle* reported that Equifax signed a "five-year contract with NCTUE to house and manage a major risk management data exchange for the communications and utility industries."

"Atlanta-based Equifax is expected to gain $20 million in revenue from the contract. NCTUE will house consumer payment data from the wireless, landline, cable, satellite, gas, electric and water utility companies. NCTUE will assist communication and utility service providers and marketers in the recovery of unpaid account balances and detection of application fraud. The data will allow for early, point-of-sale, identification of high-risk accounts among new service applications and objective risk assessment information for setting deposits," the *Chronicle* reported.

In July 2008, Equifax, which is one of three nationwide credit bureaus, announced NCTUE had extended Equifax's exclusive contract to manage its database until June 10, 2015. "Enhancements to the exchange database will now capture payment history similar to what happens today in Equifax's consumer reporting file, making it the logical alternative for those members not comfortable with full file reporting," the press release stated. "This represents a significant step forward to capturing widespread payment performance data on the unbanked and underbanked market."

NCTUE's Web site said its "members report Customer Service Applications (CSAs) to the database within 30 days of provisioning. They also report Unpaid Closed Accounts (UCAs) and UCA payment updates. All data submitted remains the property of the member at all times."

"A member submitting a CSA that matches a UCA will receive a 'match' report containing all the information in the UCA record with the exception of the name of the carrier that submitted the record. This information can be used to identify higher-risk consumer applicants, to customize credit and collections strategy, and automatically matches and reports on information received subsequent to account provisioning for six months," it continued.

"Members also receive a 'skip' report when UCA's that they submit match CSA's in the system. The source of the data is not identified unless it is against the members (sic) own data. NCTUE enhances collection and recovery processes by reporting new address and telephone information on defaulted account for 24 months."

The NCTUE Web site also described its more customized services: "'Online Inquiry' is available to members at the time of provisioning to determine whether a prospective customer has defaulted on an account with another carrier prior to initiating service. 'Reverse Append' is an optional tool that returns a name and address when a phone number is submitted. The 'Suppression Tool' allows members to screen marketing lists. Those consumers who have unpaid closed accounts in the database can be deleted from the list prior to the commencement of marketing efforts, saving the member time and money. Wireless members can utilize the 'Wireless Port Indicator' to determine the number of times a wireless number has changed carriers in the last 24 months."

To ensure that consumers know when they are being judged on the basis of records compiled by a third-party, Congress, in the FCRA, defined the term "consumer report" quite broadly:

"'Consumer report' means any written, oral, or other communication of any information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for (A) credit or insurance to be used primarily for personal, family, or household purposes; (B) employment purposes; or (C) any other purpose authorized under [this] section."

Similarly, it broadly defined the term "consumer reporting agency" as "any person which, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties, and which uses any means or facility of interstate commerce for the purpose of preparing or furnishing consumer reports."

Finally, it defined the term "file," as all of the information on that consumer recorded and retained by a consumer reporting agency regardless of how the information is stored.

"This is not even a close call. It's clearly covered by the FCRA," said one government attorney with years of FCRA experience.

Dr. Michael Turner, President of the Policy & Economic Research Council (PREC) and an expert on "full file reporting" by utilities, agreed the FCRA clearly covered NCTUE and that consumers were entitled to see their files and correct errors. He noted that in the 2003 FACT Act amendments, Congress broadened the FCRA's definition of credit to be consistent with the Equal Credit Opportunity Act (ECOA).

"This includes energy utility and telecoms services as forms of credit – to the extent that NCTUE data is being used for credit decisioning – that would be risk-based pricing," Turner said. "As such, any adverse actions based upon NCTUE data, including denial of service or the requirement to maintain a security deposit, must automatically generate an adverse action notification to be sent directly to the consumer by NCTUE members."

STATEMENT OF

STAN OLIAI

SENIOR VICE PRESIDENT,

EXPERIAN DECISION ANALYTICS

Before the

Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

U.S. House of Representatives

March 24, 2010

I. Introduction

I'd like to thank Chairman Gutierrez, Ranking Member Hensarling and Members of the Subcommittee for the opportunity to submit testimony for the record and provide information about how credit scores are developed and used. My name is Stan Oliai, and I am Senior Vice President of Experian Decision Analytics.

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. The company helps organizations to manage credit risk; detect and prevent financial fraud, including identity theft; and better understand how to serve their existing customers and reach new consumers. Experian also helps consumers improve their financial literacy by allowing them to check their credit report and credit score, and protect themselves against identity theft.

Experian is well known in the United States as one of the three national credit reporting agencies. But credit reporting is only one side of our business. In fact, we have a family of companies that are tied together by their focus on consumer data. Combined, these companies make Experian 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. I am here today to represent one of those business units, Experian Decision Analytics. Our business serves as one of the world's largest providers of software for credit scoring, fraud detection and risk-based pricing.

Credit scores are prominent in today's economy as most lenders use a score to estimate the relative risk that a consumer presents in repayment of a loan, as well as to price financial products accordingly. As we've seen the use of credit scores increase, they have provided tremendous benefits for both business and consumers. The use of credit scores for risk-based pricing has led to significant increases in efficiencies in the market. Consumer benefits include less cross-subsidization of risk, lower prices, increased compliance with the Equal Credit Opportunity Act, less bias in decision-making, 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. 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, a credit score is simply one of a variety of analytical tools lenders can use to make a decision. Each lender has its own proprietary underwriting process and uses information from multiple internal and external sources

when making a lending decision. The volume of information sought would depend on many factors, from the type of loan being offered (i.e. revolving line of credit 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. As I mentioned earlier, many 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

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.

In recent years there have been questions surrounding the cost of a credit score, with some suggesting that nationwide consumer reporting agencies should provide a free credit score to consumers when they request their credit report at www.annualcreditreport.com. At the heart of this discussion is a question of fairness for the company that developed the software to produce a score. Without software, a credit score would not exist. Therefore, this software is the intellectual property of the company that developed the scoring software. Significant investments are made in developing, maintaining, updating and marketing the credit score model. First, a developer must purchase de-personalized credit history and then, employing a highly-technical workforce to statistically analyze the credit histories, determine how predictive each factor in a file is on future behavior and risk.

Imagine the outrage at the suggestion that a company that develops software for tax filings, for example, to be required to give away its 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 rulemaking subsequent to the enactment of the Fair and Accurate Credit Transactions Act of 2003. In the Advanced Notice of Proposed Rulemaking (ANPR) of the Fair and Reasonable Fee for Credit Score Disclosure, 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."[1]

Further, 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 consumer 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."

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[1] Federal Register 64698 - 64702, November 8, 2004

The Federal Reserve has also weighed into the availability of credit scores when it recently approved the Final Rules on Risk-Based Pricing Notices. The final rule requires a creditor to provide a consumer with either a notice or a credit score disclosure, including information about their score when credit is provided on less favorable terms than is provided other consumers. When supplying a credit score, a creditor must provide a statement that includes language educating customers that "a credit score is a number that takes into account information in a consumer report and that a credit score can change over time to reflect changes in the consumer's credit history."[2] The Federal Reserve has indicated that a score disclosure is important and the most meaningful when a consumer is faced with a credit decision.

V. How Consumers Maintain a Good Score

One of the greatest misconceptions regarding credit scores is that there are fast and easy tricks a consumer can engage in to improve 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

[2] Federal Register 2724-2784, January 15, 2010

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 reasonable.

VI. 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.

VII. 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 credit, 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 transition to traditional lender services. 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 that 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 and consistent source of information. A recent study by PERC (the Political and Economic Research Council) found that fully reporting energy utility and telecommunications customer payment data to consumer reporting agencies would help 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.

STATEMENT OF

STUART K. PRATT

CONSUMER DATA INDUSTRY ASSOCIATION

WASHINGTON, D.C.

BEFORE THE

Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

House of Representatives

ON

"Keeping Score on Credit Scores: An Overview of Credit Scores, Credit Reports and their Impact on Consumers"

March 24, 2010

Chairman Gutierrez, Ranking Member Hensarling and Members of the Subcommittee, thank you for this opportunity to appear today. I am Stuart Pratt, President and CEO of the Consumer Data Industry Association (CDIA).

The CDIA is an international trade association representing approximately 250 consumer data companies that are the nation's leading institutions in credit and mortgage reporting services, decisions sciences software development, fraud prevention and risk management technologies, tenant and employment screening services, check fraud prevention and verification products, and collection services.

We commend you for holding this hearing, and welcome the opportunity to share our views.

My comments today, which are augmented materially by the written statements provided by each of our members who are with me here today at the witness table, will focus primarily on:

- The Fair Credit Reporting Act (15 U.S.C. 1681 *et seq.*): a law which provides superior protections for consumers and which allows for a vibrant and competitive industry that develops the world's best products and services, which benefit consumers.
- The three explanations requested in the letters of invitation sent to our members; and

- General background the fairness and material contribution of credit scores to consumers and our nation's economy.

Congressional Review of FCRA and Credit Histories

In 1996, and again in 2003, the congress extensively reviewed and materially updated the Fair Credit Reporting Act. This is a law which strikes the right balance between necessary protections for all of us as consumers and one that does not restrain a competitive industry which benefits both consumers and the economy.

In fact, the Fair and Accurate Credit Transactions Act of 2003[1], often known as the FACT Act, was considered a tremendous bipartisan success. It was originally passed by this committee by a vote of 63-3 and by the House by a vote of 392-30. Regarding the Senate efforts, Senator Sarbanes (D-MD), then ranking member on the Senate Banking Committee, was quoted in the Congressional Record as saying that

> *"I want to acknowledge the thorough examination of these important issues provided by the comprehensive series of six hearings on this subject that Chairman Shelby held in the Banking Committee. The bill passed unanimously out of the Banking Committee on a voice vote on September 23, 2003 and was adopted 95-2 on the floor on November 5, 2003. These votes, I believe, are a testament to our chairman's willingness to work on a bipartisan basis."*[2]

[1] PL 108-159
[2] Senate Record (GPO Version) – Page S15806 – November 24, 2003.

The FCRA regulates the operations of all consumer reporting agencies (CRAs) and thus there are many types of databases used which are covered by the statute. As previously discussed, the FCRA is a very contemporary consumer protection statute. Rights accorded to consumers are extensive and included below is the FTC's own accounting of those rights:

A Summary of Your Rights
Under the Fair Credit Reporting Act

The federal Fair Credit Reporting Act (FCRA) is designed to promote accuracy, fairness, and privacy of information in the files of every "consumer reporting agency" (CRA). Most CRAs are credit bureaus that gather and sell information about you -- such as if you pay your bills on time or have filed bankruptcy -- to creditors, employers, landlords, and other businesses. You can find the complete text of the FCRA, 15 U.S.C. 1681-1681u, at the Federal Trade Commission's web site (*http://www.ftc.gov*). The FCRA gives you specific rights, as outlined below. You may have additional rights under state law. You may contact a state or local consumer protection agency or a state attorney general to learn those rights.

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

- **You can find out what is in your file.** At your request, a CRA must give you the information in your file, and a list of everyone who has requested it recently. There is no charge for the report if a person has taken action against you because of information supplied by the CRA, if you request the report within 60 days of receiving notice of the action. You also are entitled to one free report every twelve months upon request if you certify that (1) you are unemployed and plan to seek employment within 60 days, (2) you are on welfare, or (3) your report is inaccurate due to fraud. Otherwise, a CRA may charge you up to eight dollars.

- **You can dispute inaccurate information with the CRA.** If you tell a CRA that your file contains inaccurate information, the CRA must investigate the items (usually within 30 days) by presenting to its information source all relevant evidence you submit, unless your dispute is frivolous. The source must review your evidence and report its findings to the CRA. (The source also must advise national CRAs -- to which it has provided the data -- of any error.) The CRA must give you a written report of the investigation, and a copy of your report if the investigation results in any change. If the CRA's investigation does not resolve the dispute, you may add a brief statement to your file. The CRA must normally include a summary of your statement in future reports. If an item is deleted or a dispute statement is filed, you may ask that anyone who has recently received your report be notified of the change.

- **Inaccurate information must be corrected or deleted.** A CRA must remove or correct inaccurate or unverified information from its files, usually within 30 days after you dispute it. **However, the CRA is not required to remove accurate data from your file unless**

it is outdated (as described below) or cannot be verified. If your dispute results in any change to your report, the CRA cannot reinsert into your file a disputed item unless the information source verifies its accuracy and completeness. In addition, the CRA must give you a written notice telling you it has reinserted the item. The notice must include the name, address and phone number of the information source.

- **You can dispute inaccurate items with the source of the information.** If you tell anyone -- such as a creditor who reports to a CRA -- that you dispute an item, they may not then report the information to a CRA without including a notice of your dispute. In addition, once you've notified the source of the error in writing, it may not continue to report the information if it is, in fact, an error.

- **Outdated information may not be reported.** In most cases, a CRA may not report negative information that is more than seven years old; ten years for bankruptcies.

- **Access to your file is limited.** A CRA may provide information about you only to people with a need recognized by the FCRA -- usually to consider an application with a creditor, insurer, employer, landlord, or other business.

- **Your consent is required for reports that are provided to employers, or reports that contain medical information.** A CRA may not give out information about you to your employer, or prospective employer, without your written consent. A CRA may not report medical information about you to creditors, insurers, or employers without your permission.

- **You may choose to exclude your name from CRA lists for unsolicited credit and insurance offers.** Creditors and insurers may use file information as the basis for sending you unsolicited offers of credit or insurance. Such offers must include a toll-free phone number for you to call if you want your name and address removed from future lists. If you call, you must be kept off the lists for two years. If you request, complete, and return the CRA form provided for this purpose, you must be taken off the lists indefinitely.

- **You may seek damages from violators.** If a CRA, a user or (in some cases) a provider of CRA data, violates the FCRA, you may sue them in state or federal court.

The FCRA gives several different federal agencies authority to enforce the FCRA:

FOR QUESTIONS OR CONCERNS REGARDING:	PLEASE CONTACT:
CRAs, creditors and others not listed below	Federal Trade Commission Consumer Response Center - FCRA Washington, DC 20580 1-877-382-4367 (Toll-Free)
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 Compliance Management, Mail Stop 6-6 Washington, DC 20219 800-613-6743
Federal Reserve System member banks (except national banks, and federal branches/agencies of foreign banks)	Federal Reserve Board Division of Consumer & Community Affairs 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 Consumer Programs Washington, DC 20552 800-842-6929
Federal credit unions (words "Federal Credit Union" appear in institution's name)	National Credit Union Administration 1775 Duke Street Alexandria, VA 22314 703-518-6360
State-chartered banks that are not members of the Federal Reserve System	Federal Deposit Insurance Corporation Division of Compliance & Consumer Affairs Washington, DC 20429 800-934-FDIC
Air, surface, or rail common carriers regulated by former Civil Aeronautics Board or Interstate Commerce Commission	Department of Transportation Office of Financial Management Washington, DC 20590 202-366-1306
Activities subject to the Packers and Stockyards Act, 1921	Department of Agriculture Office of Deputy Administrator - GIPSA Washington, DC 20250 202-720-7051

Explanation I – "Please explain the basics of how consumer credit reports are compiled including what sources of information you collect and how they are collected."

The FCRA defines the term "consumer report," including a subset of consumer reports that are popularly called "credit reports", which are those reports which include credit payment data and other similar data. The type of information contained in a credit report are:

- Identifying Information – Name, Current and Previous Addresses, Social Security Number, Date of Birth;
- Credit History – History of satisfying obligations to retail stores, banks, finance companies, mortgage companies and other lenders;
- Public & Collection Agency Records (that bear upon credit-worthiness) – Judgments, Foreclosures, Bankruptcies, Collections, Tax Liens, Garnishments; and

- Inquiries – Identifies credit grantors or other parties that have received a copy of the consumer's credit report, typically during the past 2 years. Also, lists companies who received consumer information for the purpose of offering credit or other promotions.

Notably, credit reports do not contain information about an individual's race, color, religion, or national origin.

The majority of all data furnished to a consumer credit reporting agency comes from lending institutions such as community banks, national and regional banks, credit unions, credit card issuers, mortgage lenders, retailers, and finance companies. These financial institutions voluntarily supply data in compliance with FCRA Section 623. CDIA estimates that there are approximately 18,000 sources of data supplying more than three billion updates to consumer files every month. Other data is supplied by third-party collection agencies which provide services to creditors and other U.S. businesses. Public record data, such as a tax lien, judgment or bankruptcy is provided by contractors to the nationwide consumer credit reporting agencies. The method by which data are supplied varies, but most is supplied either via direct, encrypted electronic submission or via various computer media such as a tape which is shipped by the financial institution.

Even in this time of economic hardship, the vast majority of data in our members' systems simply confirms what most of you would expect: consumers pay their bills on time and are responsible, good credit risks.

Contrast this positive credit history with the experience in other countries, such as Japan

or Italy, which store only negative data and do not give consumers recognition for the responsible management of their finances. Ultimately, the U.S. credit reporting system is the benchmark for other countries, and results far greater fairness measured by the allocation of risk relative to the price paid by a consumer.

We must preserve and expand on this system of risk-management data. While it might be tempting to reduce the availability of data, it is important to preserve the totality of every consumer's credit history. For instance, as discussed above, the positive credit history of a consumer demonstrates that a consumer is a responsible management of credit. It is this depth of data which helps to ensure that no one event is the final word for a lender as it responsibly and fairly estimates risk. To reduce the amount of data that is available, to prohibit data sources from furnishing the data, to require a furnisher to delay the furnishing of data or to prohibit a user from analyzing certain data are all wrong choices. Transparency between consumers and their financial institutions is a key concept. The credit report is central to this transparency, including both the most immediate payment data and also the historical record of a consumer's years of responsible credit management.

Explanation II – "Please explain the different types of reports you develop and who purchases them."

FCRA Section 604 establishes the permissible purposes for which a consumer report can be sold. The FTC's consumer rights statement says that a "consumer reporting agency

may provide information about you only to people with a valid need -- usually to consider an application with a creditor [e.g., mortgage loan, home equity line of credit, auto loan, retail installment, credit card, etc.], insurer, employer, landlord, or other business." Our members provide consumer credit reports for all permissible purposes under the FCRA where there is a market for them. These reports validate that we as consumers are responsible, careful and most often, worthy of the risks associated with the product for which we have applied. Consumer reports tell the consumer's story in an unbiased and complete fashion, allowing a consumer's whole story to be told. They also serve an essential function in our nation's economy by also ensuring the safety and soundness of lending and underwriting decisions and allowing U.S. businesses to effectively manage risks.

Explanation III – "Please detail your efforts to increase the accuracy and predictability of your reports, especially with regards to consumers with "thin files" and no previous credit histories."

The accuracy of all consumer reports (including credit reports) is a matter of law and is also a marketplace expectation.

First, the Federal Reserve Board studied approximately 300,000 credit reports for purposes of determining the quality of data. Their report included the following finding:

> *"This analysis of the effects of data problems on credit history scores indicates that the proportion of individuals affected by any single type of data problem appears to be small..."*
>
> *"Available evidence indicates that the information that credit-reporting [sic] agencies maintain on the credit-related experiences of consumers, and the credit history scoring models derived from*

these experiences, have substantially improved the overall quality of credit decisions while reducing the costs of such decision making." Avery, Robert, et al., Federal Reserve Bulletin, "Credit Report Accuracy and Access to Credit", Summer 2004.

Further, since December 2004, consumers themselves have been reviewing their credit report disclosures at rates never before seen in the history of the industry due to the system designed by our members to give consumers free access to them. Ultimately the consumer experience in reviewing their own credit report disclosures validates the conclusions of the Federal Reserve study. Between 2004 and 2006, more than 52 million free credit report disclosures were provided to consumers who exercised their rights under the FACT Act. Approximately 90% of consumers had no questions or disputes regarding their reports, and, only 1.98% of them resulted in a dispute where data was deleted from the file. The success of this program has continued and our members now estimate that since the inception of the right to a free consumer credit file disclosure in December of 2004, more than 150 million credit file disclosures have been issued.

Users of credit reports have similar experiences regarding dispute rates and the accuracy of the data used for underwriting. Consider the following, which involves 17 million credit reports:

> "In 2001, Allstate ordered over 17 million credit reports. The number of written requests from consumers disputing information on their credit report totaled less then 3,000, or .017 percent of the total number of reports ordered. Of the number of legitimate disputes, only some would have any bearing on the insurance score because we only look at certain characteristics. Of the number affecting the insurance score, only some would affect the discount amount because the score must change by a certain amount to move into another discount category. Thus, the number of inaccurate credit reports that affect the premium charged is at most a subset of a subset of a subset of .017 percent."[3]

[3] Allstate Insurance Company's Additional Written Testimony: Allstate's Use of Credit Scoring, before the Michigan Office of Financial and Insurance Services, July 23, 2002.

While there have been prior efforts to quantify the accuracy of data, none involved large or valid samples of data. In fact the General Accountability Office makes the following observation regarding these efforts:

> *"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." Statement of Richard J. Hillman, Director, Financial Markets and Community Investment, General Accountability Office, Before the Senate Banking Committee, July 31, 2003.*

The data cited above speaks to the success of our members' ongoing efforts, though they are always striving to ensure the quality of the data coming into in their systems. Following is a sampling of just some of the strategies they employ in this regard:

New data furnishers – all of our members utilize specialized staff, policies and procedural systems to evaluate each new data furnisher and assist them in becoming compliant with the data furnishing standards of our members. Common practices include reviews of licensing, references, and site visits. All apply robust tests to sample data sets and all work with the furnisher to conform data reporting to the Metro 2 data standard. Once a furnisher is approved, there may be ongoing monitoring of this data reporting stream during a probationary period of time.

Ongoing furnishing – Our members employ a variety of practices to secure continued and on-going accuracy:

• When update information is received from data furnishers, it is reviewed by the CRAs for reporting issues, which are resolved before the update information is loaded into the actual credit files... This review and reporting process helps to provide feedback to data furnishers regarding the quality of their data furnishing practices;

• Cross-referencing data in certain fields to look for logical inconsistencies is often used as a data quality check;

• Historical data reporting trends, at the database level or data furnisher level, are used as baseline metrics upon which to evaluate incoming data;

• Manual reviews of data can occur when anomalous data reporting trends are identified; and

• Reviewing incoming data for consistency with the Metro 2 data standard.

Furnishers and Metro 2 Data Reporting Standard

CDIA members have also voluntarily developed a data reporting standard for all 18,000 data sources which contribute to their databases; the latest iteration of this standard is titled Metro2.

Standardizing how data is reported to the consumer is a key strategy for improving data quality by creating a uniform and universal method of data sharing.

Use of the Metro 2 data reporting format is climbing steadily. In 2005 CDIA reported that approximately 50 percent of all data provided to our members' data bases was reported using the Metro2 Format. Today, this percentage has grown to 81.3

percent.

In addition to our members' individual efforts to encourage adoption of the Metro 2 Format, CDIA provides furnishers with free access to a "Credit Reporting Resource Guide," which is the comprehensive overview of the Metro2 Format. This guide is designed for all types of data furnishers, to encourage the proper use of the format.

This Guide also provides specific guidance for certain types of furnishers, such as collection agencies, agencies which purchase distressed debt, all parties which report data on student loans, child support enforcement agencies and utility companies, which may have unique issues that need to be addressed.

More than 500 of these guides are provided free of charge to data furnishers each year. Further, since 2004, CDIA and its Metro2 Task Force have held workshops for thousands of data furnishers on a range of specialized topics regarding Metro2 including, for example:

• Reporting of Mortgage Loans

• Reporting Requirements for Third Party Collection Agencies and Debt Purchasers; and

• Reporting Requirements Specific to Legislation & Accounts Included in Bankruptcy.

4) What about the data sources themselves and accuracy?

As this Committee knows better than any other in the House, there are also legal requirements that data furnishers must abide by regarding the accuracy of data that they submit to a consumer reporting agency.

The FACT Act made a number of significant changes to the FCRA to enhance the accuracy of consumer credit files.[4] For instance, data furnishers are prohibited from furnishing data they know is inaccurate, and they have an affirmative duty to correct and update information. A number of new FACT Act regulations are now final and include:

- Direct Disputes - The FRB, NCUA and FTC have published final guidelines and regulations that provide consumers with the opportunity to initiate disputes directly with data furnishers, as opposed to going through the CRA to run that dispute;

- Accuracy and Integrity – The same agencies have also published final guidelines and regulations to address the accuracy and integrity of the data furnished to consumer reporting agencies ; and

- Red Flag Guidelines – New rules have been finalized for resolving address discrepancies. Resolving such discrepancies at the account opening will reduce the likelihood that data reported to a consumer reporting agency is inaccurate.

[4] Federal Trade Commission, *Report to Congress Under Sections 318 and 319 of the Fair and Accurate Credit Transactions Act of 2003, Dec. 2004, vii.*

However, Congress must give these rules and regulations time to work before making additional changes to the process. In fact, the FRB and FTC issued a FACTA required study in August of 2006 that concluded that no new legislative requirements should be instituted at this time:

> "The FACT Act Section 313(b)(4) requires the FTC and the Board include in this report any legislative or administrative recommendations for improvements to the dispute process that the agencies jointly determine to be appropriate. The agencies recommend that no legislative action be taken at this time, in large part because the agencies believe such action would be premature. The FACT Act imposes a number of new requirements on CRAS and furnishers that should enhance the consumer dispute process and improve accuracy, including measures to reduce identity theft and new requirements on furnishers. Many of these requirements are being implemented, and their effects on the dispute process have yet to be seen. This is particularly important given the voluntary nature of the reporting system and the uncertainty of how additional requirements and burdens would affect that system." Federal Trade Commission "Report to Congress on the Fair Credit Reporting Act Dispute Process", August 2006, Pp. 34.

What about consumers whose credit reports cannot be scored or who simply do not have one?

CDIA's members are at the forefront of studying this question and bringing forward market-based solutions. Interestingly the Center for Economic Justice pointed out in offered in a previous congress that many "non-traditional" lenders, such as rental landlords, finance companies and other lenders often do not report any data to credit bureaus. This means that consumers who have not been part of the system, who do not have established credit, may have difficulty establishing credit, trapping them in a catch-22.

However, what this committee needs to know is that there is tremendous progress and real-world products on the market today that are helping to further address the issue of how consumers with little "traditional" payment history can establish credit and benefit from a positive payment history in a traditional underwriting process.

Publicly Available Data - Several of our members already compile public record data which can then be used for underwriting loans. A consumer's ownership of a home, a car or other asset can help contribute to an underwriting process. These data are commercially available today, are being used in credit underwriting processes where there is no traditional credit report or one which cannot be scored.

Rental and Utility Payment Data – A number of our members are adding utility and telecommunications payment data to traditional credit reporting databases or are managing utility industry payment data exchanges which are also sources for utility and telecomm payment data. These data are being used in credit underwriting decisions today. We also have members who are in direct discussions with rental payment data sources to expand reporting of these data for underwriting purposes. Other members of the CDIA are aggregating consumer payment data where such data reported by the consumer's bank through direct payments made from checking accounts.

Validating Consumer-Submitted Data – A number of our members also provide services where they will validate payment data (paid bills, etc.) provided by a consumer directly to a lender. In some cases a scoring system is built into these models.

Empirical Studies Suggest a Promising Future: FTC FACT Act Study – The December 2004 Report by the FTC to Congress under sections 318 and 319 of the Fair and Accurate Credit Transactions Act indicates that bill payment histories at utilities and telecommunications companies could be utilized as a source of predictive data. Other more recent studies have reached similar conclusions.

With this positive context in mind, it is important for this Committee to know that there are barriers to wide-spread reporting of this type of payment data which may impinge on fully integrating such data into underwriting processes. For instance, anecdotally we have heard that some companies do not want to incur the expense and potential liability associated with reporting information due to the fact that such data may be defined under telecommunications law as customer proprietary network information or CPNI. Further, State Public Utility Commissions (PUCs) may also raise barriers that prevent the reporting of valuable and predictive payment data due either to outright prohibitions and in some cases perhaps due to the lack of clear guidance.

Credit Scores –

Our members are more than nationwide consumer credit reporting companies. They are global leaders in the production of tools which help companies manage risk. Consistent with the wishes of this committee witnesses for Equifax, Experian and TransUnion have

submitted written statements each of which will inform the thinking of this committee regarding the critical value of credit scores both for consumers and for our economy as a whole. In our view the following are all important points:

- There is no one credit score. There are many score development companies in the market place today and competition is fierce. This competition ensures market-leading tools are used to the benefit of consumers and the companies with which they do business.
- Credit scores remove social bias and provide fair treatment for consumers.
- These software tools protect us as consumers from mere opinion or from the untrained eye of a new loan officer who does not have a lifetime of experience.
- Credit scores help lenders manage risk such that they can extend credit to more consumers than would otherwise be the case.
- Credit scores give consumers credit for their hard work and are a consistent measure of risk.

Summary

In summary, the nationwide consumer credit reporting system is subject to balanced regulation that effectively protects us as consumers and at the same time enables industry to innovate and produce tools which are studied by credit economies from around the globe. Our members maintain the most complete and robust sets of data of any country in the world and these data sets are expanding to help consumers who are underserved

today. We must preserve this essential risk-management data and also the decision sciences industry which is producing the world's leading tools used to manage risk at the level of an individual account, a portfolio and the national level, as well.

We thank you for the opportunity to testify and look forward to your questions.

FICO

WRITTEN TESTIMONY OF

TOM QUINN
FICO
VICE PRESIDENT, SCORES

BEFORE THE U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

Mr. Chairman and members of the subcommittee, my name is Tom Quinn. I am a Vice President in the SCORES division of FICO (formerly Fair Isaac Corporation) responsible for the management and delivery of the company's global scoring products and services. Thank you for the opportunity to testify before you today on this important topic of credit scores. I am pleased to share with you my company's perspective as a developer of credit scoring models. Credit scores play a vital role in facilitating millions of lending decisions each year and FICO recognizes the importance of communicating publicly on issues related to the use and impact of credit scores. My testimony will address the following areas: (1) a detailed overview of FICO credit scores; (2) the predictive strength of FICO's scoring model; (3) FICO's efforts to extend risk scoring to credit-underserved consumers; (4) FICO's ongoing commitment to providing helpful educational resources on a myriad of credit scoring topics; (5) FICO's continued support of consumer access to credit scores used by lenders and (6) the important role that consumer credit behavior plays in determining your FICO® score.

WHO WE ARE

FICO was founded in 1956 on the premise that data, used intelligently, can improve business decisions. FICO solutions provide key benefits to both businesses and consumers across the banking, credit card, retail, telecommunications, insurance, healthcare and government markets. These analytic solutions include FICO Falcon® Fraud Manager, the leading credit card fraud detection and prevention application, and the widely used FICO Blaze Advisor® business rules management system that automates complex business operations and processes. However, FICO is still best known for its FICO® scores, first introduced in 1989.

While there are other credit scores available to businesses, FICO® scores are the most widely used credit bureau risk scores in the world, powering about 10 billion decisions a year. The effectiveness of FICO's models at predicting credit risk is continually affirmed by our clients (lenders, insurers and other businesses) through their own validation research. FICO® credit scoring models are empirically derived, demonstrably and statistically sound, built with depersonalized data, and include features that other models may not include, such as authorized user data, that assist our clients in complying with Regulation B and other applicable federal regulations.

FICO® scores are calculated by the use of an algorithm, a mathematical formula that serves as the engine driving the production of the credit score. The fuel for this engine is the information

contained in a consumer's credit report. This credit information is housed and maintained at the three major, national consumer reporting agencies - Equifax, TransUnion and Experian (commonly referred to as the major credit bureaus).

It is important to note that FICO develops and provides separate credit scoring models, in the form of unique algorithms, to each of the three credit bureaus. This approach optimizes the unique data differences between each bureau to make the FICO® score as predictive as possible. When a lender requests a FICO® score from a credit bureau, the bureau feeds the relevant consumer credit report information into the algorithm to generate a score that it delivers to the lender. FICO is not a consumer credit bureau or a consumer credit data repository. Since the introduction of the first FICO® score, the company's role in this area has been defined by the work of its scientists who develop scoring models that help businesses better evaluate and manage risk associated with the extension of credit and insurance.

OVERVIEW OF FICO CREDIT SCORES

What is a FICO® credit score?

The FICO® score is a three digit number ranging from 300-850. The score "rank orders" consumers by the likelihood that they will become seriously delinquent (90 days or more) on a credit obligation in the next 24 months. The higher the score, the lower the risk. Lenders use credit scores as a component in their decision process to extend credit as well as to set terms (such as the interest rate). Today, credit scores are a vital part of a consumer's credit health. While there are different credit risk scores in the marketplace, the score most commonly used by lenders is the FICO® score.

What is considered in the FICO® score?

The FICO credit scoring model considers a wide variety of information found in consumer credit reports maintained by the three major credit bureaus. This includes information from credit obligations (e.g., credit card, mortgage and home equity line accounts), consumer-initiated credit inquiries, collections, and derogatory public records (e.g., bankruptcies and liens). The data used to calculate the FICO® score can be grouped into five primary categories as outlined below. The accompanying percentages are meant to give an indication of how important each of the categories is in determining a FICO® score.

- Payment history (35%)
- Amounts owed (30%)
- Length of credit history (15%)
- Pursuit of new credit (10%)
- Mix of credit (10%)

As noted above, payment history and amounts owed (level of indebtedness) are the two strongest predictive categories in the FICO® score. For payment history, the score assesses both positive and negative payment information as reported in the consumer's credit file. When negative payment information is present, the score assesses the magnitude, frequency, and recency of

missed payments or other derogatory information in the credit report such as bankruptcies and collections. For amounts owed, the score considers how much a consumer owes to various lenders, including the relationship between outstanding debt and the total amount of credit that is available to the consumer. The remaining three predictive categories are length of credit history, pursuit of new credit and mix of credit. Generally speaking, consumers who have demonstrated a longer history of positive credit behavior have been shown to expose lenders to less credit risk. Those who are seeking credit as measured by excessive inquiry behavior or the opening of multiple new credit obligations have been found to pose more risk to lenders than those who have not been aggressively pursuing new credit (see below for more discussion on the treatment of rate-shopping activity). Finally, the FICO® score examines the mix of credit that a consumer possesses such as credit cards, retail cards, and installment loans. Consumers who demonstrate the ability to successfully manage a variety of different credit types generally pose less credit risk.

A few additional comments regarding the score composition are worth noting:

- The FICO® score takes into consideration all of the above categories of information, not just one or two. Also, the importance of any factor depends on all of the information in the consumer's credit report. For some people, a particular factor may be more important to their score than for someone else with a different credit history.

- The FICO® score incorporates special logic in the treatment of inquiries. First, the score is focused on inquiries where a consumer is actively seeking credit. Second, the score contains rate-shopping logic to ensure that multiple inquiries associated with a single search for a mortgage, auto, or student loan are treated as a single inquiry. In addition, the score ignores inquiries related to rate-shopping that are made within 30 days of scoring.

What is not considered in the FICO® score?

It is also important to know what information is not considered by the FICO scoring model. FICO® scores do not consider:

- A consumer's race, religion, national origin, sex or marital status
- A consumer's age
- A consumer's income, occupation, title, employer, date employed or unemployment history
- A consumer's address
- Any interest rate being charged on a particular credit or other account
- The value of a consumer's assets
- Certain types of inquiries (e.g., requests by consumers for their own credit report or score)
- Any information not found in the consumer's credit report
- Any information that is not proven to be predictive of future credit performance

FICO

How is the FICO scoring model developed?

FICO pioneered the way automated credit scoring systems are developed. The creation of the FICO scoring model requires FICO to obtain from each of the major credit bureaus representative national samples of depersonalized credit reports spaced two years apart for the same set of consumers. FICO's analytic scientists then study the data in the earlier data snapshot to isolate and prioritize factors that consistently predict the credit account performance observed two years later in the second data set. Those factors found to be most powerful and consistent in predicting credit performance, individually and in combinations, form the basis for the complex mathematical algorithms which become the predictive scoring models.

How are FICO® scores generated?

A lender seeking to use a consumer's FICO® score as part of a credit decision will contract with one or more of the credit bureaus. In response, the bureau assembles information from the consumer's credit file and feeds it into the FICO algorithm housed within their system which calculates the FICO® score. The bureau delivers the FICO® score to the lender along with up to five reason statements that explain which credit report factors had the greatest influence on why the FICO® score was not higher.

Who uses FICO® scores and what are the benefits?

Credit scores are used by businesses in a wide range of industries and across the consumer credit lifecycle:

- Acquisition: Lenders leverage credit scores to help them identify those lower risk consumers to whom they wish to offer pre-approved credit.
- Origination: When a consumer applies for a car loan, mortgage, home equity line, credit card or subscribes to a cell phone plan, the creditor may check the consumer's FICO® score to help determine whether they will decline or approve the application for credit and to help set loan terms such as interest rate and credit line assignment.
- Account management: Lenders use credit scores to help determine what actions to take on their existing customers. For example, a credit card issuer may consider the FICO® score of a current customer when deciding whether to increase the customer's credit line or to cross sell other financial services.

FICO® scores offer a wide range of benefits to both lenders and consumers. FICO® scores give lenders a fast, objective estimate of a consumer's credit risk. This results in quick decision making, faster processing of loans and fewer defaults. Consumers can take comfort in knowing that FICO® scores only focus on the facts related to credit risk, rather than personal opinions or potential biases. The use of these scores helps customers receive fast and fair decisions from lenders and gain access to a wider availability of credit.

FICO

PREDICTIVE STRENGTH OF FICO'S SCORING MODELS

The FICO credit risk model is not static – it undergoes continual innovation. FICO analytic scientists regularly study credit bureau data samples to test the predictive value of the factors considered by the FICO scoring model. Through empirical analysis of the data, FICO has consistently been able to update its algorithm resulting in a more predictive scoring model. In fact, the latest scoring model – FICO® 8 – generates the most predictive FICO® score in history.

Lenders and insurers' use of credit-based scoring models to effectively evaluate risk has been validated by a wide range of research, including two 2007 studies conducted by the Federal Reserve and the Federal Trade Commission (FTC) respectively, pursuant to Section 215 of the Fair and Accurate Credit Transactions Act of 2003 (*Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit* and *Credit-Based Insurance Scores: Impacts on Consumer Automobile Insurance*). While the Federal Reserve's study focused on credit risk scores and the FTC research examined credit-based insurance scores, both studies concluded that credit-based scores are effective predictors of risk in both the credit and insurance markets.

EXTENDING RISK SCORING TO CREDIT-UNDERSERVED CONSUMERS

FICO has been a leader in the use of alternative data to improve risk assessment for consumers with "thin" or no traditional credit bureau files. In 2004, FICO launched its FICO® Expansion Score to address the estimated 30-50 million consumers for whom insufficient credit history data exists at the three major credit bureaus to calculate a traditional FICO score. The FICO® Expansion Score model evaluates both positive and negative 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. Like the FICO® score, the FICO® Expansion Score model uses the same score range and rank orders consumers by the likelihood that they will become seriously delinquent (90 days or more) on a credit account within the next 24 months. The FICO® Expansion Score provides lenders with a credit risk score they can use to more effectively evaluate and extend credit to underserved customers that may include recent immigrants, young adults and those who have not used traditional credit in the recent past.

COMMITMENT TO CONSUMER EDUCATION

FICO is strongly committed to providing consumers with freely accessible educational resources on credit scores. More than nine years ago, FICO launched its consumer website, www.myFICO.com, which quickly became a central source of information for consumers and others interested in learning about credit scores and related topics. The educational resources contained on the website include a list of credit factors that are assessed by the FICO scoring model and explanations that address what information the model ignores, how consumers can take action to manage their scores over time, how to prepare for a loan, and much more. Also, myFICO® created an 18-page booklet for consumers titled "Understanding Your FICO Score" which is available in hardcopy and can be downloaded from the website. In addition, myFICO®

has partnered with the Consumer Federation of America on a consumer-focused pamphlet called "Your Credit Scores" which has been distributed to thousands of consumers nationwide and is available through the U.S. General Services Administration's Federal Citizen Information Center (FCIC) and on the FCIC website. More recently, FICO created a permanent, public online discussion forum for consumers called FICO Forums. Currently, more than 340,000 users have registered at the FICO Forums to discuss and compare notes on hundreds of credit scoring topics and related issues. Some consumers are not only active in the Forum but have accumulated sufficient knowledge to now serve this community as voluntary Forum moderators.

myFICO.com also has served as the primary destination for consumers who wish to obtain their FICO® scores. For a modest fee, consumers gain access to the same credit scores that are most widely used by lenders. The information provided includes the FICO® score, the underlying credit report on which it was generated, a detailed explanation of the score, the score range, a distribution chart that indicates where the consumer stands within a national distribution of consumer credit scores and the primary reasons why the score is not higher. To date, more than 20 million FICO® scores have been delivered directly to consumers via myFICO.com and other affiliates. Also, myFICO.com has introduced additional products to help consumers monitor their FICO® scores and credit reports, protect against fraud and identity theft, and provide coaching on successful credit management practices.

In addition to the educational resources published on the myFICO.com website, FICO participates in numerous speaking and education training events and serves as a resource for government and non-profit groups. In the past few months, FICO staff has spoken at Federal Reserve Bank, Federal Deposit Insurance Corporation and National Association of Insurance Commissioners events, provided credit score information to state attorneys general and the U.S. Government Accountability Office and appeared on a panel at the annual Consumer Federation of America Consumer Assembly conference.

CONSUMER ACCESS TO CREDIT SCORES USED BY LENDERS

FICO continues to support efforts to ensure that consumers have access to credit scores used in making lending decisions. While a variety of credit scores are available to consumers, FICO believes that consumers benefit most when they can obtain credit scores that are actually used by lenders to make credit decisions. There are a number of ways that consumers can gain access to these credit scores, including:

- **myFICO.com.** As previously mentioned, FICO® scores from Equifax and TransUnion are available for $15.95 at www.myfico.com.
- **When applying for a home mortgage.** Pursuant to the 2003 FACT Act, Section 609 (g) requires that all lenders who use a credit score in connection with an application for a home mortgage provide the applicant with a current credit score that was calculated for a purpose related to the extension of credit.
- **Via FICO® ScoreView.** FICO is working with several large banks to introduce a program called FICO® ScoreView in which bank customers view their FICO® score when they access their accounts electronically. Through an agreement with FICO, banks provide consenting customers with free FICO scores monthly, along with score

explanations and extensive credit management educational content via participating lenders' secure banking websites.

- **In circumstances when risk-based pricing is used.** On December 22, 2009, the Federal Reserve Board and the Federal Trade Commission issued a final rule that generally requires a creditor to provide a risk-based pricing notice to a consumer when the creditor uses a consumer report to grant or extend credit to the consumer on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers from or through that creditor. The final rule includes an exception for creditors to provide a consumer with a disclosure of the consumer's credit score in conjunction with additional information that provides context for the credit score disclosure. We expect the credit score disclosure exception to be the most widely used method of complying with the rule. If this holds true, many consumers who apply for credit will begin receiving credit scores as early as January 1, 2011, the effective date of the new rule.

FICO remains committed to supporting these and other efforts that put meaningful information in the hands of consumers and empower them to become better-educated as well as to develop successful credit management practices.

CONSUMER BEHAVIOR DRIVES CREDIT SCORES

In my role at FICO, I am often asked, "How can a person improve his or her credit score?" Credit scores are not static; they are constantly changing based on a consumer's credit behavior. There are no silver bullets for rapidly raising a low score, but there are a few guidelines that, if adopted, will very likely impact a consumer's score in a positive way.

- First, pay your bills on time – consistently.
- Second, keep credit card balances low.
- Third, don't open new credit accounts you don't need.
- Fourth, check your credit report to ensure its accuracy.
- Finally, be patient – demonstrate your responsible credit habits over time.

Improved credit scores are a natural byproduct of healthy credit habits and sound financial management practices.

Thank you for the opportunity to testify before you today.

PREPARED STATEMENT OF

THE FEDERAL TRADE COMMISSION

"KEEPING SCORE ON CREDIT SCORES: AN OVERVIEW OF CREDIT SCORES, CREDIT REPORTS AND THEIR IMPACT ON CONSUMERS"

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

MARCH 24, 2010

I. Introduction

Chairman Gutierrez and members of the Subcommittee, my name is David Vladeck, and I am the Director of the Bureau of Consumer Protection at the Federal Trade Commission ("Commission" or "FTC").[1] I appreciate the opportunity to appear before you today to discuss the Commission's efforts to implement the Fair and Accurate Credit Transactions Act of 2003 ("FACT Act"), including the provisions that increase the transparency of how credit scores are used. The FACT Act required the Commission, alone and, in other cases, with other agencies, to issue almost 30 rules, guidelines, compliance forms, notices, educational campaigns, studies, and reports. The Commission has completed all of the required rules, guidelines, forms and notices, as well as many significant studies. For example, it has completed a rulemaking to ensure that consumers have access to free annual credit reports; a rulemaking to enhance consumers' rights to dispute errors in their credit reports; and a study on the use of credit scores in the automobile insurance industry.

This testimony first provides some background on the FACT Act[2] and the Fair Credit Reporting Act ("FCRA"),[3] and their treatment of credit scores. Next, it discusses the Commission's efforts to implement the FACT Act. It then summarizes the results of the study addressing the use of credit scores for automobile insurance. Finally, it summarizes the Commission's work to increase transparency of credit scores following enactment of the FACT

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[1] While the views expressed in this statement represent the views of the Commission, my oral presentation and responses to questions are my own and do not necessarily reflect the views of the Commission or any individual Commissioner.

[2] Pub. L. No. 108-159, 117 Stat. 1952 (Dec. 4, 2003) (codified in scattered sections of 15 U.S.C.).

[3] 15 U.S.C. § 1681 et seq.

Act.

II. Background on the FACT Act, the Fair Credit Reporting Act, and Credit Scores

The FACT Act amended the FCRA, the federal law that governs the operation of the nation's consumer reporting system. The FCRA regulates the practices of consumer reporting agencies ("CRAs"), furnishers (entities that provide information to CRAs), and users of credit reports (such as entities extending credit) to ensure that sensitive credit report information is used with fairness, impartiality, and respect for the consumer's privacy. The Commission shares enforcement authority for the FCRA with the federal banking regulatory agencies ("banking agencies"),[4] and has played a central role in interpreting and enforcing the FCRA since its inception.

The FACT Act amended the FCRA to, among other things, improve the accuracy of credit reports, enhance privacy, and prevent identity theft. For instance, the FACT Act facilitates consumers' access to their credit reports by granting them the right to free annual reports,[5] and gives identity theft victims a number of new remedies for eliminating fraudulent information from their reports. In addition, several FACT Act provisions are designed to improve the effectiveness of the process for consumers to dispute errors in credit reports and thus enhance the accuracy of these reports.

The FACT Act also gave consumers the right to purchase a credit score from CRAs,[6] and

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[4] As used here, this term applies to the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System ("Federal Reserve"), Federal Deposit Insurance Corporation, Office of Thrift Supervision, and National Credit Union Administration.

[5] 15 U.S.C. § 1681j(a)(1)(A)-(B); 15 U.S.C. § 1681j(a)(1)(C).

[6] *Id.* § 1681g(f).

required certain mortgage lenders to provide a score without charge to home loan applicants.[7] Prior to the enactment of the FACT Act, the Commission testified before Congress about the importance of consumers having access to their credit scores and understanding what factors are considered to calculate the scores.[8] The Commission noted that, "[w]ith sufficient knowledge about the score and what it means, consumers may use that information as a valuable shopping tool."[9] Subsequently, the FACT Act gave consumers a right to obtain access to their credit scores. As a result, consumers have had better access to their credit scores over the last several years.

III. Commission Actions Implementing the FACT Act

As noted above, the FACT Act assigned the Commission the responsibility, alone and in some cases with one or more other agencies, to promulgate approximately twenty implementing rules, guidelines, compliance forms, and notices, and conduct nine studies and issue reports to Congress. The Commission has completed all of the FACT Act-mandated rules, guidelines, forms, and notices and has finished many of the mandated studies.

A. Significant Rules

Among the most significant recent actions the FTC and other agencies have completed are the Furnisher Rules[10] and Risk-Based Pricing Rule.[11] In addition, the Commission recently

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[7] *Id.* § 1681g(g). Credit scores are based on analyses of historical consumer credit data, which allow creditors to develop models that help them predict the risk of default of a particular consumer.

[8] *See* Prepared Statement of the Federal Trade Commission, *Credit Scoring,* before the House Banking and Financial Services Committee Subcommittee on Financial Institutions and Consumer Credit (Sept. 21, 2000), *available at* http://www.ftc.gov/os/2000/09/creditscoring.htm.

[9] *Id.*

[10] Final Rule: Procedures to Enhance the Accuracy and Integrity of Information Furnished to Consumer Reporting Agencies Under Section 312 of the Fair and Accurate Credit Transactions Act, 74

amended the Free Credit Report Rule,[12] originally issued in 2004. Each of these rules will take effect over the course of the next year.

Furnisher Rules

On July 1, 2009, the FTC and banking agencies published final rules and guidelines relating to furnishers of information to CRAs. Section 312 of the FACT Act required the agencies to promulgate: (1) coordinated rules to ensure the accuracy and integrity of information furnished to CRAs ("the Accuracy Rule"), and (2) a joint rule identifying circumstances under which furnishers must investigate a dispute in response to a consumer's direct request ("the Direct Dispute Rule").

The Accuracy Rule requires each furnisher to establish reasonable policies and procedures for implementing specific guidelines designed to ensure the accuracy and integrity of information furnished to CRAs. For example, the guidelines state that when furnishers report an outstanding balance on a credit account, they should also report the consumer's credit limit. This is because the failure to include a credit limit can cause credit evaluators to inaccurately estimate how much available credit a consumer is using, which is an important factor in assessing creditworthiness. The agencies also issued an Advance Notice of Proposed Rulemaking to identify other possible information that furnishers should report, such as the date

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Fed. Reg. 31484 (July 1, 2009), *available at* http://www.ftc.gov/os/2009/07/R611017factafrn.pdf.

[11] Final Rule: Fair Credit Reporting Risk-Based Pricing Regulations, 75 Fed. Reg. 2724 (Jan. 15, 2010), *available at* http://edocket.access.gpo.gov/2010/pdf/E9-30678.pdf.

[12] Final Rule: Free Annual File Disclosures, 75 Fed. Reg. 9726 (Mar. 3, 2010), *available at* http://edocket.access.gpo.gov/2010/pdf/2010-4273.pdf.

an account was opened.[13]

The Direct Dispute Rule requires furnishers in most cases to investigate disputes that consumers submit directly to them regarding the accuracy of information that the furnishers reported to a CRA. Previously, the law only required CRAs to resolve consumers' disputes. The final Rule allows consumers to dispute possible credit report inaccuracies not only with the CRAs, but also directly with the company that provided the information. The effective date for the Accuracy Rule and Direct Dispute Rule is July 1, 2010.

Risk-Based Pricing Rules

The FTC and Federal Reserve announced final rules on December 22, 2009, pursuant to section 311 of the FACT Act, which generally require a creditor to provide a consumer with a risk-based pricing notice when, based on information in the individual's credit report, the creditor provides credit to an individual on less favorable terms than it provides to others.[14] These risk-based pricing notices supplement the adverse action provisions of the FCRA, which require CRAs to provide "adverse action notices" to consumers who are being denied credit based on information in their credit report. Consumers who receive a risk-based pricing notice will be able to obtain a free credit report to check the accuracy of the report. As an alternative to providing risk-based pricing notices, the rules permit creditors to provide all consumers who

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[13] Among other things, the Agencies sought information about whether the absence of an account opening date causes credit evaluators to calculate inaccurately the length of a consumer's credit history, and the impact this may have on assessments of the consumers' creditworthiness. *See* Interagency Advance Notice of Proposed Rulemaking: Guidelines for Furnishers of Information to Consumer Reporting Agencies, 74 Fed. Reg. 31529 (July 1, 2009), *available at* http://www.ftc.gov/os/2009/07/R611017factaanpr.pdf. The agencies received 18 comments in response and are reviewing the comments to determine whether to issue a notice of proposed rulemaking.

[14] Final Rule: Fair Credit Reporting Risk-Based Pricing Regulations, 75 Fed. Reg. 2724 (Jan. 15, 2010), *available at* http://edocket.access.gpo.gov/2010/pdf/E9-30678.pdf.

apply for credit with a free credit score and information about their score. Whichever method a creditor engaged in risk-based pricing chooses to employ, consumers who receive credit on less favorable terms due to information in their credit report will receive education about credit reports and will be informed of their right to request a copy of their reports to check their accuracy. The rules become effective on January 1, 2011.

Free Credit Report Rule

Pursuant to the FACT Act, the Commission originally promulgated the Free Credit Report Rule specifying the procedures for consumers to obtain free annual file disclosures (also known as free credit reports) from nationwide CRAs and nationwide specialty CRAs in 2004.[15] The Rule required that the nationwide CRAs jointly establish and operate a centralized source from which consumers can obtain free annual credit reports through a single dedicated Internet website (AnnualCreditReport.com),[16] a toll-free telephone number, and a postal address.[17] The purpose of the Rule was to enable consumers to detect and dispute inaccurate or incomplete information in the files of nationwide CRAs by providing consumers with the opportunity to obtain annual credit reports free of charge.

Since issuance of the Free Credit Report Rule, there has been a proliferation of confusing advertising regarding where consumers can obtain their free annual credit reports. Some

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[15] Prior to the FACT Act, consumers could purchase file disclosures from CRAs, but could receive a free file disclosure only under limited circumstances. For example, section 615 of the FCRA provides that consumers denied credit or employment based upon information contained in a credit report may obtain a free file disclosure from the CRA that provided the report. 15 U.S.C. § 1681m.

[16] Most requests for free annual file disclosures through the centralized source occur through the AnnualCreditReport.com website. AnnualCreditReport.com is the only federally authorized website for obtaining free annual file disclosures.

[17] 16 C.F.R. 610.2(a).

nationwide CRAs and others have advertised "free credit reports" in connection with the consumer's purchase of certain products and services, such as credit scores and credit monitoring. Although some advertising predated the original Rule, the bulk of the advertising for "free credit reports" now takes advantage of consumers' general knowledge that free annual credit reports are available under federal law. These advertisements direct consumers not to AnnualCreditReport.com, the only authorized source for free annual credit reports, but to commercial websites operated by nationwide CRAs or others that sell a variety of products and services. The Commission has sought to address this confusion through enforcement actions, education, and most recently, an amendment to the Free Credit Report Rule that requires specific disclosures on all commercial offers of free credit reports.

On the enforcement front, in 2005, the Commission filed an action against Consumerinfo.com, Inc., a marketer of "free credit reports."[18] In that action, the Commission alleged that Consumerinfo.com, Inc. engaged in deceptive acts or practices in violation of section 5 of the FTC Act. These deceptive practices included failing to disclose or to disclose adequately that the "free" annual credit reports they were offering were not associated with the federally mandated annual free credit report program, but rather were part of a commercial promotion. The company entered into a settlement with the FTC that required Consumerinfo.com, Inc., to pay consumer redress, prohibited it from making deceptive and misleading claims about "free" credit reports, and required disclosure of the terms and

[18] Complaint for Injunctive and Other Equitable Relief, FTC v. Consumerinfo.com, Inc., No. SACV05-801 AHS (MLGx) (C.D. Cal. Aug. 15, 2005).

conditions of any "free" offers.[19] The defendant also agreed to forgo $950,000 in ill-gotten gains. Two years later, the Commission entered into a second order with Consumerinfo.com, Inc., settling allegations that it violated the 2005 order and requiring an additional $300,000 for consumer redress.[20]

The Commission also has made extensive outreach efforts to educate consumers about their right to a free credit report through the authorized source. When the free annual credit report program initially took effect in 2004, the FTC issued press advisories and radio public service announcements informing consumers of their new rights, and published a "how to" guide on ordering the federally-mandated free reports.[21] The Commission also has issued public warnings about "imposter" sites that pose as the official free report site, AnnualCreditReport.com.[22] In addition, the FTC has created videos that highlight the differences between AnnualCreditReport.com and other sites that claim to provide "free" credit reports.

Despite these enforcement and other consumer outreach efforts, consumers continue to be misled and confused about where to obtain the free annual file disclosure mandated by federal law. Recognizing this confusion, section 205 of the Credit CARD Act of 2009 required the

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[19] Stipulated Final Judgment and Order for Permanent Injunction, FTC v. Consumerinfo.com, Inc., No. SACV05-801 AHS (MLGx) (C.D. Cal., Aug. 15, 2005).

[20] Supplemental Stipulated Judgment and Order for Permanent Injunction and Monetary Relief, FTC v. Consumerinfo.com, Inc., No. SACV05-801 AHS (MLGx) (C.D. Cal., Jan. 8, 2007) (prohibiting defendant from failing to make required disclosures mandated by the 2005 order and requiring $300,000 payment for consumer redress).

[21] *See* http://www.ftc.gov/bcp/conline/pubs/credit/freereports.shtm.

[22] *See* http://www.ftc.gov/bcp/edu/pubs/consumer/alerts/alt156.shtm; http://www.ftc.gov/bcp/conline/pubs/alerts/fakealrt.shtm; .http://www.ftc.gov/opa/2009/03/freecredit.shtm.

Commission to issue a rule to prevent deceptive marketing of "free" credit reports. On February 22, 2010, the Commission published an amended Free Credit Report Rule. To dispel consumer confusion, the amended Rule requires advertisements for "free" credit reports to include certain prominent disclosures to make clear that these "free" offers are not the federally mandated free file disclosure available through the centralized source. The final rule also requires nationwide CRAs to delay advertising for other products and services through the centralized source until after consumers have received their free annual credit report, and prohibits other practices that may interfere with a consumer's ability to obtain a free annual file disclosure. This final rule becomes effective on April 2, 2010, except for the wording of the disclosures for television and radio advertisements, for which the effective date is September 1, 2010.

B. Additional Rules, Guides, Forms, and Notices

In the past few years, the Commission has also completed a number of other significant tasks in implementing the FACT Act. The following list highlights those accomplishments.

• *"Circumvention" Rule.* Pursuant to section 211(b) of the FACT Act, on February 24, 2004, the Commission published a rule that barred nationwide CRAs from reorganizing or taking other steps to avoid fulfilling their duties to provide free credit reports.[23]

• *"Identity Theft" Rules and Summary.* On November 3, 2004, the Commission defined the terms "identity theft" and "identity theft report" for the purposes of various identity theft-related provisions of the Act, pursuant to section 111 of the FACT Act.[24] In addition, the Commission established by rule the duration of active duty alerts available to members of the armed services and defined what constitutes "appropriate proof of identity" for certain purposes, as required by section 112. The Commission also published a model form that CRAs must provide to identity

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[23] Interim Final Rule: Prohibition Against Circumventing Treatment As a Nationwide Consumer Reporting Agency, 69 Fed. Reg. 8532 (Feb. 24, 2004), *available at* http://edocket.access.gpo.gov/2004/pdf/04-3978.pdf.

[24] Final Rule: Related Identity Theft Definitions, Duration of Active Duty Alerts, and Appropriate Proof of Identity Under the Fair Credit Reporting Act, 69 Fed. Reg. 63922 (Nov. 3, 2004), *available at* http://edocket.access.gpo.gov/2004/pdf/04-24589.pdf.

theft victims, summarizing victims' FCRA rights.

• *"Records Disposal" Rule.* Pursuant to section 216 of the FACT Act, on November 24, 2004, the Commission and other agencies published coordinated final rules requiring proper disposal of credit report information.[25] These rules require entities to take reasonable measures to dispose of covered information in a manner that reduces the risk of identity theft.

• *"Summary and Notices."* Pursuant to section 211 of the FACT Act, on November 30, 2004, the Commission published standard notices that CRAs must give to consumers when providing them with their credit reports, summarizing consumers' rights under the FCRA.[26] The Commission also issued notices that CRAs must provide to information furnishers and credit report users summarizing their FCRA duties. These notices are revisions to notices previously prescribed by the Commission in 1997.[27]

• *"Prescreen Opt-Out Notice" Rule.* Section 213(a) of the FACT Act directed the Commission, in consultation with the banking agencies, to prescribe a simple and easy-to-understand notice that creditors and insurers must include in written "prescreened" offers. On January 31, 2005, the Commission published such a notice, which informs consumers of their right to opt out of prescreened offers and explains how to do so.[28]

• *"Identity Theft Forms and Procedures" Guidance.* On April 27, 2005, the Commission published guidance to implement section 153 of the FACT Act.[29] Section 153 directed the Commission, in consultation with the banking agencies, to develop a model form for identity theft victims to use to contact creditors and CRAs.

• *Medical Information Rule.* Section 411 of the FACT Act amended the FCRA to prohibit creditors from obtaining or using medical information in determining a consumer's eligibility for

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[25] Final Rule: Disposal of Consumer Report Information and Credit, 69 Fed. Reg. 68690 (Nov. 24, 2004), *available at* http://www.ftc.gov/os/2004/11/041118disposalfrn.pdf.

[26] Final Rule: Summaries of Rights and Notices of Duties Under the Fair Credit Reporting Act, 69 Fed. Reg. 69776 (Nov. 30, 2004), *available at* http://edocket.access.gpo.gov/2004/pdf/04-26240.pdf.

[27] Section 211(c) of the FACT Act specifically required the Commission to revise the consumer summary form. The Act did not require revision of the furnisher or user notices, but various changes to the FCRA introduced by the FACT Act rendered the existing forms obsolete. The Commission is planning to seek public comment on proposed further revisions to the notices, to reflect additional changes in the rights of consumers and obligations of CRAs and furnishers, created by several new FACT Act rules issued within the past year.

[28] Final Rule: Prescreen Opt-Out Disclosure, 70 Fed. Reg. 5022 (Jan. 31, 2005), *available at* http://edocket.access.gpo.gov/2005/pdf/05-1678.pdf.

[29] Notice of Federal Trade Commission Publication, 70 Fed. Reg. 21792 (Apr. 27, 2005), *available at* http://edocket.access.gpo.gov/2005/pdf/05-8376.pdf.

credit, except as permitted by regulations to be issued by the banking agencies (but not including the FTC). The agencies issued final regulations on November 17, 2005.[30] The Commission provided extensive written comments to the banking agencies to aid in the rulemaking proceeding.

• *Nationwide Identity Theft Campaign.* In 2006, the Commission launched a nationwide identity theft consumer education program mandated by the FACT Act, centered around the themes "Deter, Detect, and Defend." This campaign includes information about how victims can mitigate the damage caused by identity theft should it occur.

• *"Affiliate Marketing" Rule.* Section 214 of the FACT Act requires the FTC, the banking agencies, and other agencies to promulgate coordinated rules to provide consumers with notice and a right to opt out of affiliates' use of certain personal information for marketing purposes. The agencies issued a final rule on October 30, 2007.[31]

• *Credit Score Fee Determination.* Section 212(b) of the FACT Act requires the Commission to determine a "fair and reasonable" fee that CRAs may charge for a credit score. On November 3, 2004, the Commission published an Advanced Notice of Proposed Rulemaking seeking public comment on various approaches to determining the fee.[32] The Commission is continuing to monitor the credit score market to ensure that the market remains vigorous and competitive.

• *Complaint Sharing Program.* Section 313(a) of the FACT Act directed the Commission to establish a complaint sharing program, either voluntarily or by regulation, with the nationwide CRAs.[33] In early 2004, the Commission staff reached agreements with each of the three nationwide CRAs on the operation of the complaint referral program. Beginning in April 2004, Commission staff began forwarding to the CRAs on a monthly basis relevant consumer complaints from the Commission's complaint database.[34] Under this program, the Commission refers to the CRAs consumer complaints it receives in which the consumer alleges that the CRA failed to properly resolve a dispute filed by the consumer. The CRAs are required to review the complaints, report back to the Commission on the actions taken as a result of the review,

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[30] Final Rule: Fair Credit Reporting Medical Information Regulations, 70 Fed. Reg. 70664 (Nov. 17, 2005), *available at* http://edocket.access.gpo.gov/2005/pdf/05-22830.pdf.

[31] Final Rule: Affiliate Marketing Rule, 72 Fed. Reg. 61424 (Oct. 30, 2007), *available at* http://edocket.access.gpo.gov/2007/pdf/E7-21348.pdf.

[32] Advance Notice of Proposed Rulemaking: Fair and Reasonable Fee For Credit Score Disclosure, 69 Fed. Reg. 64698 (Nov. 8, 2004), *available at* http://edocket.access.gpo.gov/2004/pdf/04-24841.pdf.

[33] 15 U.S.C. § 1681i(e).

[34] *See* FTC press release, "FTC Will Refer Consumer Complaints to Credit Bureaus" (Apr. 23, 2004), *available at* http://www.ftc.gov/opa/2004/04/cra.htm.

and maintain records sufficient to show compliance.

• *"Red Flags" Rules.* The agencies issued the final Identity Theft Red Flags and Discrepancy Rules on October 31, 2007, requiring creditors to establish reasonable procedures to identify identity theft risks, and providing guidance for users of credit reports who are notified of a discrepancy between the address in a consumer's credit file and that on a credit application.[35] At the request of Members of Congress, the Commission has delayed enforcement of the Rule until June 1, 2010.

C. Studies and Reports

The Commission, alone or with one or more other agencies, has completed multiple FACT Act-mandated studies and transmitted reports to Congress. In addition, the Commission has ongoing study obligations, requiring periodic reports over several years, and certain studies that are still in progress.

• *Accuracy Studies.* On December 9, 2004, the Commission submitted a report to Congress on the accuracy of credit reports, as required by section 318 of the FACT Act.[36] In addition, section 319 of the FACT Act requires the Commission to undertake an ongoing study of the accuracy and completeness of information contained in credit reports. The Commission has, to date, released three interim reports, in December 2004, December 2006, and December 2008.[37] These reports discussed previous research in the area and the Commission's efforts to develop and test an effective methodology for studying credit report accuracy at the national level. As described in the 2008 report, the Commission believes it has developed an effective methodology; we expect that the study will be in progress in late Spring of this year. The upcoming December 2010 interim Report to Congress will highlight the goals and methodology of the national study.

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[35] Final Rule: Identity Theft Red Flags and Address Discrepancies Under the Fair and Accurate Credit Transactions Act of 2003, 72 Fed. Reg. 63718 (Nov. 9, 2007), *available at* http://edocket.access.gpo.gov/2007/pdf/07-5453.pdf.

[36] Federal Trade Commission, *Report to Congress Under Sections 318 and 319 of the Fair and Accurate Credit Transactions Act of 2003* (Dec. 9, 2004), *available at* http://www.ftc.gov/reports/facta/041209factarpt.pdf.

[37] *See* Federal Trade Commission, *Report to Congress Under Sections 318 and 319 of the Fair and Accurate Credit Transactions Act of 2003,* 18-20 (Dec. 29, 2004), *available at* http://www.ftc.gov/reports/facta/041209factarpt.pdf; Federal Trade Commission, *Report to Congress Under Sections 318 and 319 of the Fair and Accurate Credit Transactions Act of 2003* (Dec. 9, 2004), *available at* http://www.ftc.gov/reports/facta/041209factarpt.pdf; Federal Trade Commission, *Report to Congress Under Sections 318 and 319 of the Fair and Accurate Credit Transactions Act of 2003* (Dec. 23, 2008), *available at* http://www.ftc.gov/os/2008/12/P044804factarptcongress.pdf.

• *Dispute Study*. Section 313(b) of the FACT Act required the Commission and the Federal Reserve to conduct a study of the extent to which CRAs and furnishers are complying with the consumer dispute provisions of the FCRA. The agencies issued the report on the study on August 9, 2006.[38] The report included a detailed discussion of the responsibilities of CRAs and furnishers in the dispute process. The report also described concerns voiced by some commenters about the quality of the CRAs' and furnishers' investigations. The report did not recommend additional administrative or legislative action, but rather that the FACT Act provisions intended to improve the dispute process be given time to take effect. The Commission and the Federal Reserve Board will continue to monitor the performance of the dispute process, especially after July 1, 2010 when the Furnisher Rules' dispute-related provisions take effect, and explore possible improvements to the system.

• *Affiliate-Sharing Study*. Section 214 of the FACT Act requires the Commission and the banking agencies to conduct an ongoing study of the affiliate-sharing practices of financial institutions and other creditors or users of credit reports. To date, the Agencies have received results of the study and are working on a drafting a joint report.

• *Credit-Based Insurance Score Studies*. Section 215 of the FACT Act requires the Commission, along with the Federal Reserve, to study the use of credit scores and credit-based insurance scores in consumer credit and automobile and homeowners insurance markets. The results of the automobile insurance study are summarized below. The Commission is currently working on a follow-on report with an analysis of the effects of credit-based insurance scores used for homeowner's insurance. This report will use extensive insurance policy data collected through the use of compulsory process from the nine largest insurance firms, who together make up more than half of the homeowners insurance market.

IV. Credit-Based Automobile Insurance Score Study

The FTC's automobile insurance study used data that a consortium of insurance firms voluntarily submitted to the agency. Specifically, the FTC staff obtained, through a third-party actuarial firm, automobile insurance policy data for five firms representing 27 percent of the United States automobile insurance market in 2000. Commission staff supplemented and confirmed this data with information it obtained from a variety of other public and private

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[38] Federal Trade Commission & Board of Governors of the Federal Reserve System, *Report to Congress on the Fair Credit Reporting Act Dispute Process* (Aug. 9, 2006) ("Dispute Study"), *available* http://www.ftc.gov/os/comments/fcradispute/P044808fcradisputeprocessreporttocongress.pdf.

sources. FTC staff then conducted an econometric analysis of this data.

In July 2007, the Commission issued a report describing the results of its automobile insurance study.[39] In the report, the FTC made a number of findings. First, the Commission found that insurance companies are increasingly using credit-based insurance scores in making decisions as to coverage and premiums. Second, it found that credit-based insurance scores are effective predictors of risk measured by the number and total cost of claims policyholders will file. Third, the FTC found that credit-based insurance scores are distributed differently among racial and ethnic groups, and therefore likely have an effect on the insurance premiums that these groups pay, on average, with non-Hispanic white and Asian-American consumers paying less and African-American and Hispanic consumers paying more. Finally, it found that credit-based insurance scores appear to have little effect as a "proxy" for membership in these groups in estimating risk associated with automobile insurance.

V. The Commission's Efforts to Improve Transparency of Credit Scores

As noted above, the FACT Act increased the transparency of and consumers' access to credit scores, such as by giving consumers a new right to receive their credit scores. In addition, the Commission has sought to improve the information about credit scores available to consumers so that they understand what the score means and how and by whom they are being

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[39] Federal Trade Commission, *Report to Congress on Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance* (Jul. 24, 2007), *available at* http://www.ftc.gov/os/2007/07/P044804FACTA_Report_Credit-Based_Insurance_Scores.pdf. Commissioner Pamela Jones Harbour dissented from this report because she disagreed with the methodology used to generate it. In her view, the data collection and analysis fell short of the Commission's gold standard for rigor and completeness, and did not reflect the agency's best practices. Commissioner Harbour's distrust of the integrity of the underlying data set upon which the study was based caused her to doubt the reliability of any conclusions drawn by the report. *See* Dissenting Statement of Commissioner Pamela Jones Harbour, *available* at http://www.ftc.gov/os/2007/07/P044804_facta_dissenting_harbour.pdf.

used. First, as discussed above, the Risk-Based Pricing Rule allows creditors to provide a free credit score, along with information about that score, to all consumers instead of providing risk-based pricing notices to specific consumers. Indeed, the Rule includes a model consumer-friendly credit score disclosure that can provide "at a glance" information for consumers about their credit scores. The Commission believes that, rather than providing risk-based pricing notices, many entities will provide free credit score disclosures so that they do not have to conduct the analysis necessary to determine which consumers should receive a risk-based pricing notice. This will serve to further improve the availability of credit score information.

Second, the Commission continues to educate consumers about the role and impact of credit scoring in credit and insurance determinations. Our publication, *Need Credit or Insurance? Your Credit Score Helps Determine What You'll Pay*[40], explains how credit scoring works and how it is used by lenders and insurance companies.

Finally, as the Subcommittee is aware, Commission has been engaged in ongoing research about the impact of credit-based insurance scores. The Commission expects that its reports on this subject will improve transparency of information about credit scores in the insurance context.

VI. Conclusion

The FACT Act significantly increased the protections afforded to consumers in ensuring the accuracy of the information in credit reports, preventing identity theft, and improving transparency of credit scores. The Commission, along with its sister agencies, has nearly completed implementation the FACT Act through rulemakings, studies, and other actions. The

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[40] http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre24.pdf

Commission will focus its efforts on interpreting and enforcing the rules issued pursuant to the FACT Act, and the agency looks forward to working with this Subcommittee on these and other consumer protection issues.

TransUnion

Before the Financial Institutions and Consumer Credit Subcommittee of the
Financial Services Committee
United States House of Representatives

TransUnion Testimony

By Chet Wiermanski, Global Chief Scientist
Analytic and Decision Systems, TransUnion LLC

Wednesday March 24, 2010

On the Topic:

"Keeping Score on Credit Scores:
An Overview of Credit Scores, Credit Reports,
and Their Impact on Consumers"

Good afternoon Chairman Gutierrez and Ranking Member Hensarling. Thank you for your invitation to provide testimony to your subcommittee this afternoon. My name is Chet Wiermanski, and I am the Global Chief Scientist for Analytic and Decision Systems at TransUnion, LLC. It is my pleasure to appear before you today to discuss the important issues related to credit scoring.

The Evolution, Benefits, and Underlying Processes of Credit Scores

First and foremost, it is important to explain what a credit score is. A credit score is a numeric value reflecting the empirical opinion of the score developer as to the likelihood of a future credit behavior by a consumer as compared to other consumers (*e.g.*, creditworthiness). The score or value is objectively derived from several historical behavioral patterns or factors assembled from a variety of trustworthy data sources, most notably from the consumer's credit report. Prior to credit scoring, lenders relied on subjective assessments, in particular the individual loan officer's manual evaluation of a credit application and credit report to determine whether the consumer was a good credit risk. Credit scoring standardizes the lender's decision making process within and across its organization and reduces the potential for impermissible judgmental actions by its employees. Credit scoring allows for an objective and uniform approach to credit applications and account management decisions.

It is important to note that there is not "one" credit score for a consumer. Any given credit score is dependent upon the data and methodology used to develop and subsequently produce the opinion, the numeric value, in a lending environment. There are hundreds of credit scoring models in use today and most lenders do not rely on or use only one score.[1] Credit scores are developed independently by lenders, consumer reporting agencies, and credit score providers. Many lenders use different credit scoring models for different purposes or products within their own organizations. For example, a lender may use one model for credit card applications but a different model for mortgage underwriting, an auto loan, or for prioritization of collection activities. What cannot be disputed about

[1] In 2009, TransUnion alone provided hundreds of millions of its proprietary TransRisk credit scores to its customers.

credit scoring models is that if they are properly empirically derived and statistically validated they are predictive of credit risk.

In Attachment A, I provide further background on the evolution, benefits and processes of credit scores.

How well are these credit risk models performing during this recession?

Based upon more than 100 customer specific validations and TransUnion's internal validation of its proprietary generic credit risk and bankruptcy models (using millions of credit scores) calculated from 2007 credit report information and subsequent credit performance derived from 2009 credit report information, TransUnion's proprietary models performed as expected. That is, they are performing as well as similar validations on credit scores calculated on 2004, 2005, and 2006 credit information. In addition to differentiating between acceptable and unacceptable credit performers during the 2007 and 2009 timeframe, each model's ability to rank order credit risk remained consistent to the validation results from validation data set based upon prerecession credit conditions.

In Attachments B and C, I provide copies of very recent TransUnion press releases reporting a *decline* for the last two quarters of 2009 in the TransUnion Insurance Risk Index, and a leveling in the 4th Quarter of 2009 of the TransUnion Credit Risk Index. We believe this is good news in both instances, and also provides a clear illustration of credit scores and insurance scores being affected differently by the same economic environment.

A recent concern regarding credit-based scoring systems, in particular insurance risk models, is that proactive actions taken by lenders to reduce potential losses by lowering revolving credit limits may artificially lower a consumer's insurance score, which penalizes consumers in the form of higher premiums and less favorable terms to the consumer. Based upon TransUnion's analysis it appears that from an insurance risk score perspective, the action of lowering revolving credit limits has not played a significant role in the small fluctuations observed in the national average for TransUnion Insurance Risk Scores (TUIRS). This is attributed to the manner in which debt and credit utilization credit characteristics are designed and weighted within this model as compared to a credit risk model. Based upon empirical evidence uncovered when developing TUIRS, only a relatively few credit utilization characteristics, of the dozens tested, were highly correlated to insurance loss ratio and subsequently included within the models. Revolving credit utilization, by itself, is not one of those characteristics.

What Consumers Need to Know about Credit Scoring Models and Credit Scores

We believe that the following 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 contains several dimensions—first, what is the frequency and severity of any previous account delinquencies, or instances of non-payment or other default? How many delinquent accounts are on the consumer's credit report? How recent, or long ago, were these delinquencies? How many years has the individual maintained prompt payment behavior?
    ii. Amount of existing debt and capacity to absorb additional debt. How much debt has the consumer taken on? How recent was this debt undertaken? How fully

has the individual maximized his or her available credit? What is the ratio of current outstanding debt to credit limits on open-end accounts?

iii. Recent credit-seeking behavior. What are the indications that a consumer is actively seeking to obtain additional credit? The number of recent loans and the presence of recent consumer initiated inquiries are often a very strong indicator of this behavior. Most, if not all, credit bureau based scoring models bundle similar multiple inquiries and treat them as one inquiry as they are associated with a single credit transaction such as shopping for home or auto.

iv. Balanced use of credit (credit cards, mortgages, installment loans). Does the individual have a healthy mix of credit, such as unsecured credit cards, installment loans for autos or other major purchases, and home mortgages? Is the individual using them responsibly by not overextending his or her credit obligations?

b. Consumers should be aware that there are many different types of credit scoring models, and factors considered by lenders—both public and proprietary—that affect a lender's decision-making process. Creditors often apply additional, proprietary decision steps or rules to supplement the credit scores received from their proprietary models and generic credit bureau models (such as income and collateral). This process typically involves the evaluation of multiple credit scores, features of the loan (credit limit, interest rate, collateral), the lender's existing relationship, if any, with the consumer and the creditor's previous credit experience with the applicant. All of this information is evaluated together to form the basis of a lender's 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 or imply to individual consumers (through legislation, regulation or the media) that a specific score using a specific model will necessarily result in a particular outcome, irrespective of other circumstances. For example, a consumer's income, current employment status, collateral (in a secured lending context), or other factors may significantly affect a lender's decision notwithstanding the credit score.

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 their credit report. It is the individual's credit activity, rather than any particular credit score, that is key to producing the result—that is, the exact terms and conditions which lenders and insurers are able to offer to that particular person. (Consumers can review their credit reports annually at no cost through www.annualcreditreport.com, a website maintained by TransUnion and the other nationwide credit reporting companies. In 2009, TransUnion alone provided 7,900,371 free file disclosures through this public service.)

d. Credit histories, and credit scores essentially reflect the past behavior of an 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 shared among two or more individuals will thus appear on their individual credit histories, and depending upon the credit scoring system this information may or may not impact an individual's credit scores. Therefore, the type of contractual relationship and 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: No. Inquires associated with checking your own report and credit score are considered "soft inquiries" and have no impact on your credit score.
- Myth: There's only one score that most lenders use to determine my credit-worthiness.
  Fact: No. There are hundreds of different credit scoring models used by lenders in the marketplace today. To see where you stand with respect to the general population, generic credit bureau scores can be purchased online from a variety of sources. But remember, the data in the report is more important than the score so select a service that also provides credit report summaries that are easy to understand.
- Myth: Closing old credit card accounts will clean up your credit report and improve your credit score.
  Fact: Not in all instances. Some people advocate closing old and inactive accounts as a way to manage their credit. In most cases, closing older accounts will make a credit history appear shorter, which may negatively impact the overall credit score.
- Myth: Once you pay off a delinquent loan or credit card balance, the item is removed from your credit report.
  Fact: No. Negative information such as late payments, collection accounts and bankruptcies reflects your history and it will remain on your credit report for up to seven years. Certain types of bankruptcies appear for up to 10 years. Paying off a delinquent account or credit card balance is more recent history, it does not change the past. For example, this action will update the account to indicate that the account is "paid" which will, over time, improve your credit score.

Score Disclosures to Consumers

TransUnion was the first nationwide consumer reporting company to announce, in May, 2000, our plans to make generic credit risk 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. A growing marketplace soon evolved, to the point that today information on credit scores is widely available to consumers. Our own affiliate markets consumer credit educational services under the *TrueCredit*™ brand. It 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 companies [TransUnion, Equifax and Experian] is offered for $14.95 per month.) In addition, consumers exercising their rights to a free annual disclosure of their TransUnion credit report at the centralized site (www.annualcreditreport.com) maintained in conjunction with the other nationwide consumer reporting companies, may also obtain their VantageScore™ for a fee of $7.95.

This balance between the right to obtain a free annual credit report from each of the three national consumer reporting companies and the right of the consumer reporting companies to charge a reasonable fee for the sale of credit scores, subject to Federal Trade Commission oversight, was carefully crafted by the Congress in the 2003 amendments to the Fair Credit Reporting Act ("FCRA"). Today, millions of consumers each year exercise

their rights to obtain a free annual credit report, and some of these consumers 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 generic credit scores based upon the underlying information contained in a credit report.

We strongly believe that it is appropriate for companies, including TransUnion, to have the right to charge a reasonable fee for the service of calculating a credit score and providing it to a consumer. As I discussed above, a credit score is simply a numeric expression of an opinion, based upon a consumer's current credit profile, as to the likelihood that a consumer will satisfactorily repay their credit obligations in the future. A company should be permitted to charge for such an opinion—just as an appraiser may charge a fee when providing an opinion on the value of one's home, car, or jewelry. It is also important to note that a credit score is distinctly different from the consumer's underlying credit report. Congress has made a public policy determination that consumers should have access to their credit reports from certain credit bureaus at no cost at least once annually. This allows consumers to review the information in their credit report and to ensure that the information is accurate. There is no similar policy justification with respect to the disclosure of a credit score.

To the extent that Members of the Committee believe that consumers should receive a credit score periodically, it is worth noting that the Final Rule recently promulgated jointly by the Federal Reserve and the Federal Trade Commission implementing the FCRA's Risk-Based Pricing Notification provision will offer another opportunity to consumers applying for new credit to obtain a credit score disclosure at no cost to them. The Final Rule allows creditors which offer risk-based pricing a choice between providing a risk-based pricing notice to certain applicants or a score disclosure to all approved applicants. Because of the complexity of the rule for identifying which consumers must receive a risk-based pricing notice, we believe that many credit grantors will opt for the score disclosure alternative. In this outcome, millions of consumers may receive free score disclosures each year from their lender(s).

We believe it is important for consumers to understand how they may be evaluated for credit, and that is why information relating to the components of a credit score is 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. 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, including an interactive video presentation on credit reports, credit report accuracy, and credit scores. We provide a DVD version of this video material to consumer and community organizations upon request. Our press release on this development is Attachment D.
- As a national sponsor of the non-profit organization, Operation Hope[2]. 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, credit and financial principles. We

[2] http://operationhope.org/

also provide scores and reports to Operation Hope to aid in their financial counseling at Hope Centers around the country.

- As a sponsor of the Jump$tart Coalition for Personal Financial Literacy[3]. The Jump$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 other essential service providers, that a more complete credit profile can be evaluated by lenders, allowing more consumers to be brought into the mainstream credit economy and become more financially literate.

Credit-based Insurance Scores

TransUnion Insurance Risk Scores are based on objective, factual, accurate credit report information, including consumer accounts such as credit cards, retail store cards, mortgages, and auto loans, as well as public record information, including bankruptcies, liens and judgments. Additionally, TUIRS takes into consideration consumer initiated inquiries associated with their request for new credit accounts. Multiple consumer generated credit inquiries associated with the shopping for a mortgage or auto loan are de-duplicated to minimize the impact on their score. All of this factual credit information is received from tens of thousands of financial institutions, retailers, and court houses on a monthly basis. I should also note what is not included in the credit report and or in the calculation of a consumer's TUIRS: medical history and records, consumer buying habits, checking and savings information, income, or any prohibited basis characteristics identified by the Federal Reserve, which includes information regarding marital status, race, age, religion, family status, color, receipt of public assistance, disability, gender or national origin.

TUIRS were developed to be completely transparent at all levels of the policy cycle. Thus, insurance agents and consumers have a clear understanding of the credit characteristics impacting their insurance score and how insurance scores may potentially be improved. With each TUIRS adverse action reason code message, we provide an explanation detailing why the insurance score is less than ideal. All characteristics and algorithms used to create TUIRS are available upon request, providing a clearer understanding of all the credit elements that impact a consumer's insurance score.

It is important to note that while the term credit score is often used interchangeably by many for credit and insurance decisioning, credit-based insurance scores and credit risk scores are not synonymous. Credit-based risk scores are designed to predict the likelihood that an individual will satisfactorily repay their credit obligations, while insurance scores are designed to predict a claims loss ratio. TUIRS was developed to meet the needs of our insurance customers who seek a transparent, objective, and accurate predictor of consumer insurance risk.

[3] http://www.jumpstartcoalition.org/

The TransUnion Perspective on the Alternative Data Issue

The Committee asked about our efforts towards improving accuracy and completeness of credit reports, especially in regards to consumers with "thin files" and no previous credit histories. For more than 20 years, TransUnion has encouraged the full file reporting of "non-traditional" information furnishers from 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,"[4] which TransUnion proudly supported. In July 2008, 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"*.[5]

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 collaborated with PERC in a follow-up study to learn more about the impediments—whether systemic, political, legal or otherwise—which are faced by the

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[4] 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.

[5] **(Washington, DC)** The Political and Economic Research Council (PERC) introduces its new applied study center, The Markets and Information Nexus (MAIN) with the release of *You Score You Win: the Consequences of Giving Credit Where Credit is Due*. This study shows that fully reporting energy utility and telephone service customer payment data to consumer reporting agencies would help up to 70 million Americans gain access to affordable mainstream sources of credit.
In the midst of the credit crunch and sub-prime meltdown new tools are needed to access credit in a responsible way. This approach to reporting can help lessen some of the impacts of the current credit crisis. Some of the key findings are:

- evidence does not support the claim that reporting utility and telecom payment data will worsen the credit scores of more disadvantaged consumers
- evidence shows that consumers whose telecom and utility payments are reported do not become overextended, as measured by a rise in late payments. This report is a follow-up to an earlier joint report from PERC and the Brookings Institution Urban Markets Initiative that showed fully reporting—reporting timely payments and late payments—to credit bureaus dramatically increases credit access for people with little or no credit history—a group overwhelmingly comprised of lower income Americans, members of ethnic minority communities especially immigrants, younger and elderly Americans.

utilities and telecommunications companies who might otherwise wish to begin full-file reporting. PERC published the results of that study[6] in March, 2009. In general, the findings supported the earlier work, and emphasized the need for robust communications to the consumer about reporting practices.

Finally, we are presently engaged with PERC in a follow up to the 2006 study, to determine if the current recession has had any impact on the benefits to consumers described in the 2006 report. We hope to see this new study published later in 2010.

The TransUnion Perspective on Current Legislation

Exclusion of Specific Information from Scoring Models

Congress from time to time considers proposals to prohibit certain types of information from being considered by credit scoring models. Generally speaking, TransUnion believes that statistically significant and valid information should be available to lenders for making credit decisions, so long as the data does not run afoul of the "prohibited basis" provisions in the Equal Credit Opportunity Act. A current example of such legislation is H.R. 3421, introduced by Representative Kilroy. This bill would prohibit consumer reporting agencies from including in a consumer report any record of a paid medical debt that had been in collection. Thus this information would no longer be available to scoring models.

We share the view of many that the medical payments system in our country has much room for improvement. We also acknowledge the fact that some scoring models, such as *VantageScore*™ and our own insurance scoring model do not consider paid medical collections, and thus those two scoring models would be unaffected if this bill became law.

Nevertheless, we object to this bill for these reasons:

1. Paid medical collection information continues to have predictive value for some scoring models, particularly those associated with the collection of charged off bad debt. Account information that is accurate and that meets the reporting requirements of the FCRA should not be arbitrarily excluded from consumer reports.
2. To date, Congress has generally not interfered with the use of predictive information when making credit decisions, and we do not believe it would be appropriate to change course in the current lending environment. In fact, we fear that once Congress decides to intervene with respect to the use of certain debts in underwriting models that it will be difficult to draw a line as to where Congress should stop, and the process of underwriting will become a more politicized process.

Use of Consumer Credit Reports by Employers

At present there are bills in 15 or more states which would restrict or ban the use of credit reports by employers. Congress currently has at least one such bill, H.R. 3149 by Representative Cohen. Subject to certain narrow exceptions, this bill would prohibit use of consumer credit reports for employment purposes.

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[6] Turner, Michael A., Robin Varghese, Patrick Walker and Katrina Dusek, "Credit Reporting Customer Payment Data: Impact on Customer Payment Behavior and Furnisher Costs and Benefits," Chapel Hill, North Carolina, PERC Press.

Employers seek credit reports on job applicants from TransUnion for a variety of reasons, including to verify that an applicant has a history of financial responsibility and to confirm identity. A 2008 report[7] by the Association of Certified Fraud Examiners found that the two most commonly occurring "behavioral red flags" among persons found to be responsible for occupational fraud were "living beyond means" and "financial difficulties". Proper use of a credit report could reduce the risk of such occupational fraud. That report also found occupational fraud occurring across a wide variety of industries and types of organizations.[8]

The FCRA already provides significant consumer protections when credit reports are used by employers. The employer must provide the prospective employee a clear and conspicuous written notice stating that a consumer report may be obtained for employment purposes, and the prospective employee must authorize that procurement in writing. The employer must also provide a copy of the consumer credit report together with a summary of the individual's rights under FCRA Section 615 to the individual prior to taking an adverse action. The applicant has a right to review this credit report and to dispute any information with the consumer reporting agency believed to be inaccurate or incomplete. This point in the hiring process also allows the consumer an opportunity to explain derogatory information to the employer.

We acknowledge that there may be a need among some employers to adopt best practices in the use of credit reports. Properly used, a credit report can reflect an individual's financial responsibility and stability over a period of many years. Especially in these difficult economic times, we do not believe that a single negative incident on a credit report should necessarily be used by a prospective employer as a reason to decline employment.

We believe it is worth noting that credit scores are not used in connection with employment. TransUnion will not provide any score on a credit report that is obtained for employment purposes. We support best practices concerning use of credit reports for employment purposes such as the following:

- The reason for obtaining a credit report for employment purposes is to evaluate an individual's financial stability and responsibility. Accordingly, isolated individual items of adverse information should receive little to no weight if the overall picture presented by the report shows a history of responsibility and stability.
- Certain types of information should not be given any weight, such as paid medical collections, and minor payment delinquencies—especially if these do not appear to form part of a larger pattern. In some circumstances is may be appropriate to ignore foreclosures—especially if there is offsetting, mitigating information. There are already restrictions in federal law against prospective employers considering bankruptcy.[9]
- Credit risk scores should not be used.

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[7] Association of Certified Fraud Examiners, "2008 Report to the Nation on Occupational Fraud and Abuse".
[8] Types of industry, in decreasing order of frequency: banking, government, healthcare, manufacturing, retain, education, insurance, construction, religious/charitable/social services, services—other, services—professional, real estate, technology, utilities, oil and gas, wholesale trade, arts/entertainment/recreation, telecommunications, communications/publishing, agriculture/forestry. Frequency by types of organization: private company—39%; public company—28%; government—18%; not for profit—14%.
[9] 11 U.S.C. § 525(b).

- Use of credit reports as part of a pre-employment screening regime makes sense when the position has access to assets or confidential personal information.
- Credit reports should be obtained only on finalist candidates—it is unnecessary to obtain a credit report on all job applicants.

Free Score Disclosure by Consumer Reporting Agencies

There are at least two bills currently before the Financial Services Committee requiring consumer reporting agencies to make free score disclosures—H.R. 2374 by Rep. Rodriguez and H.R. 4538 by Rep. Cohen. H.R. 2374 would require consumer reporting agencies to provide, upon request and at no charge to the consumer, a credit score in connection with the free annual file disclosure. The bill would also require free score disclosures directly to the consumer by certain credit grantors. H.R. 4538 would require consumer reporting agencies to maintain for one year, in each individual's credit file, any score that was calculated by the consumer reporting agency on that individual. The consumer reporting agency would then be required to disclose all of those credit scores, and information related to them, to the individual in connection with the individual receiving his or her free annual file disclosure.

For all the reasons discussed above, we believe that credit scores are already widely available in the marketplace. That availability will increase, perhaps exponentially, when the Final Rule on Risk Based Pricing takes effect in 2011. We also do not believe that someone should be required to provide their opinion or expertise without being able to charge for it. To the extent any requirement were to be adopted, we feel it is unfair to impose a free disclosure requirement only on consumer reporting companies when many others, including major score developers, are providing access to scores under a wide variety of value propositions. Further, we believe that to the extent free credit scores are provided, it makes the most sense for the disclosure to be made by the lender (or insurer) in connection with a current transaction with the individual and for clear disclosure by these decision makers whether that credit score was the deciding factor in the transaction. As we noted above, we believe that the accuracy and completeness of the information in his or her credit report is the most important area of focus for the individual when receiving the free annual disclosure.

For all these reasons, we believe that the requirement of Rep. Cohen's bill—to maintain a one-year history of scores and related information, to be included in the consumer's annual free file disclosure would substantially increase the costs of credit to consumers and would focus consumers on the wrong data—which would be a very poor policy outcome for consumers. We believe the proper focus is the accuracy and completeness of the credit report information and that has been addressed by the free annual file disclosure requirement. There is already a trend toward increased free credit score disclosures by lenders which are transactional and current. If the consumer wishes to obtain a score from a consumer reporting agency, we ought to be allowed to charge a fair and reasonable fee.

Again, I thank you for the opportunity to appear before you today. I hope you find this information to be responsive to your inquiry, and I would appreciate the opportunity to answer any questions you may have.

Attachment A

The Evolution, Benefits, and Processes of Credit Scores

Lenders have used various types of scoring models to promote fair and uniform lending decisions long before the arrival of generic credit risk scoring models developed from the databases of national credit bureaus such as TransUnion. These models were generally developed on the experience of the individual lenders using them, and thus were based on a relatively small population of a few thousand loans. Scoring algorithm development companies 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 is the fact 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 stable and robust scoring models which are highly predictive of consumer credit risk as they not based on the experience 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 manage their risk exposure at multiple levels. Credit scoring model based exclusively upon credit bureau information allowed for the implementation of more granular, risk-based pricing strategies, which have in turn led to decreased credit costs, and increased the availability of credit to consumers. 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 more likely to become bankrupt, was produced in conjunction with an Atlanta-based model developer named Management Decision Systems. Later, in conjunction with Minneapolis-based Fair Isaac, another generic credit risk model was introduced, *Empirica*. In the ensuing years, *Delphi* and *Empirica*, their successor versions, and subsequent competing products have evolved and grown to be more and more commonly used due to the benefits they provide to both lenders and consumers. For example:

1. Not the sole determinate of credit eligibility, yet improving risk assessment. Credit bureau based scores are contractually intended to be used in conjunction with additional information either provided directly from the credit applicant (e.g. income, employment status, length of residence), internal information available to the lender from other contractual relationships with the consumer (deposit and asset information, performance with previous credit obligations), or other third party information (property appraisals, employment verification, identify verification) when assessing the credit eligibility of the consumer. When used as a supplement to either a judgmental underwriting system based upon expert human judgment or an automated underwriting process credit report

information and credit bureau based scores add to the consistency, objectivity, speed and accuracy of the underwriting process.

2. A valid credit risk assessment tool for a variety of loan products and credit applications. Most credit risk scoring models predict a general dimension of creditworthiness, and are used throughout the account life cycle on a wide variety of credit-risk decisions.

3. Fair and objective. Credit bureau scoring models are based exclusively upon unbiased, objective 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.

4. Uniform Application. From the standpoint of risk management, uniform application of a quantifiable, consistent decision criteria results in loan portfolios (or group of insurance policies) which can be expected to perform consistently over time. In contrast, the performance of loans or policies 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 many European countries. This is based, in part, on the existence of a reliable consumer credit reporting information infrastructure, which allowed the creation of highly predictable credit scoring algorithms.

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 rates, credit limits or other product features and levels of service can be offered to consumers based on the risk reflected in the score. Because credit scores provide a very granular scale (e.g. *VantageScore*™ ranges from 501 to 990), risk managers can adjust multiple decision strategies based upon the different points assigned by the scoring model.

6. Promotes Competition. As noted above, the use of risk scores allows financial institutions and property/casualty insurance providers to make decisions without reliance on individual 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 US in the past 10 years is in part attributable to the deployment of decision systems that rely upon credit bureau based scores.

Underlying Processes of credit scores—selecting scores and factors.

The components used to develop credit risk models and subsequently calculate a consumer's credit score are based an objective approach whereby hundreds, and often thousands, 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 behavior 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 its relative importance and relationship with other characteristics selected. Characteristics that cannot be rationalized from this process are then replaced with other characteristics and the preliminary credit model is reevaluated until all characteristics selected for the final model can be logically understood and explained by the team of statisticians involved in the project.

Attachment B

TransUnion Insurance Risk Index Declines for Second Straight Quarter

Chicago, March 22, 2010 – New TransUnion data finds that its proprietary Insurance Risk Index declined for the second straight quarter at the end of 2009, possibly pointing towards a moderation in risk for the U.S. insurance industry. Developed as a risk barometer specifically for the insurance industry, the Insurance Risk Index is designed to show the relative expected loss ratio for market segments throughout the country.

The Insurance Risk Index decreased by 14 basis points in the fourth quarter of 2009, falling from 99.46 in the third quarter of 2009 to the current 99.32 level. The last time the Insurance Risk Index decreased two consecutive quarters was prior to the current recession between the fourth quarter of 2006 and the first quarter of 2007.

The key ingredient in the Insurance Risk Index is TransUnion's insurance risk models, which are influenced by the length and stability of responsible credit performance. Benchmarked to the U.S. national average of 100 as of March 31, 2001, the Insurance Risk Index facilitates comparisons across geographies and demographic segments. For example, a state with an index of 110 is 10 percent riskier than a state with an index of 100.

"The drop in the Insurance Index is encouraging news for the industry and consumers," said TransUnion's Geoff Hakel, group vice president, Insurance business unit. "Allowing the insurance industry to compare the risk level of states in which they operate to their own portfolios creates an environment where more informed risk decisions can be made. Better portfolio management has the potential to lead to better insurance pricing for consumers."

TransUnion's Insurance Risk Index – Statistics
From an insurance risk perspective, the Insurance Risk Index posted its second noticeable decrease since the fourth quarter of 2007. More importantly, every state, except Connecticut, Minnesota and Mississippi exhibited a decline from the previous quarter. Year over year, the Insurance Risk Index has increased only 0.14 percent since the fourth quarter of 2008.

Montana continues to rank as the riskiest state with an index of 109.33. It is followed by Washington (105.56), Mississippi (103.02) and Arkansas (101.78). The states demonstrating the least risk from an insurance risk perspective are Alaska (94.80), Minnesota (95.34), Massachusetts (95.41) and Hawaii (95.82).

Analysis
"The Insurance Risk Index, which today stands below 100, should continue to drift slightly lower and then flatten out over the next few quarters as employment conditions across the U.S. improve. Improving employment conditions enable more consumers to remain current on their existing credit obligations, as the timely repayment of credit obligations is an important component within TransUnion's insurance risk models. " said Chet Wiermanski, global chief scientist at TransUnion. "In particular, the second consecutive quarterly decline in the Insurance risk Index within more than 47 states is very encouraging."

TransUnion's Trend Data database

The source of the underlying data used for this analysis is TransUnion's Trend Data, a one-of-a-kind database consisting of 27 million anonymous consumer records randomly sampled every quarter from TransUnion's national consumer credit database. Each record contains more than 200 credit variables that illustrate consumer credit usage and performance. Since 1992, TransUnion has been aggregating this information at the county, Metropolitan Statistical Area (MSA), state and national levels.
www.transunion.com/trendcrate

About TransUnion
As a global leader in credit and information management, TransUnion creates advantages for millions of people around the world by gathering, analyzing and delivering information. For businesses, TransUnion helps improve efficiency, manage risk, reduce costs and increase revenue by delivering comprehensive data and advanced analytics and decisioning. For consumers, TransUnion provides the tools, resources and education to help manage their credit health and achieve their financial goals. Through these and other efforts, TransUnion is working to build stronger economies worldwide. Founded in 1968 and headquartered in Chicago, TransUnion employs associates in more than 25 countries on five continents. www.transunion.com/business

Attachment C

TransUnion Credit Risk Index Plateaus, Suggesting Improved Consumer Risk Conditions for the U.S.

Chicago, March 16, 2010 – TransUnion reported that during the fourth quarter of 2009 the Credit Risk Index (CRI) indicated that risk conditions in the U.S. are beginning to moderate. The Credit Risk Index is a statistic developed to measure the changes in average consumer credit risk within various geographies across the nation.

During the fourth quarter of 2009, TransUnion's Credit Risk Index increased nationally 38 basis points to129.67 from 129.29 in the third quarter, the smallest increase of this measure since the early stages of the current recession.

"Based upon the Credit Risk Index it appears that we may have possibly reached a plateau for credit risk after five consecutive quarters of significant increases, suggesting that the financial recovery is beginning to take hold as consumers continue to adapt their lifestyle and debt management practices to navigate these difficult economic times," said Chet Wiermanski, global chief scientist at TransUnion.

TransUnion Credit Risk Index – Statistics
Although the Credit Risk Index continued its climb reaching an all-time high at the national level for the fifth consecutive quarter; the growth rate continued to decelerate, as 10 states, predominately located east of the Mississippi river (Alabama, Tennessee, Illinois, Kentucky, District of Columbia, Rhode Island, Vermont, Maine, Alaska, and North Carolina) experienced quarterly declines.

The rate of increase between the third and fourth quarters for the Credit Risk Index was the lowest since the end of 2008, when the nation experienced a 2.61 percent decline from 120.89 to 117.74. On a year-over-year basis, the Credit Risk Index increased 3.92 percent (from 124.79 in the fourth quarter of 2008).

On a state basis, Mississippi continues to rank as the riskiest state, from a credit risk perspective, with a Credit Risk Index of 169.22. It is followed closely by Nevada (167.19) and Texas (164.23). Continuing from the previous quarters, the least risky states are concentrated in New England and the Upper Midwest areas of the country, with North Dakota coming in at 84.76, Minnesota at 91.50 and Vermont at 92.97.

Analysis
"We anticipate the Credit Risk Index will remain flat as consumers continue to take on less bank card debt and as employment conditions improve," said Wiermanski. "The prospect of a decrease in the Credit Risk Index for the first time in more than two years possibly as early as the end of 2010 continues to improve as the economic recovery expands to a greater number of states in the coming months."

The Credit Risk Index is defined as the weighted average probability of 90-day delinquency or worse among consumers in a given region relative to the nation as a whole. The Credit Risk Index uses the fourth quarter of 1998 as a baseline for comparison. Therefore, it

measures changes in consumer credit score distributions relative to the national distribution and delinquency rates as a whole at the end of 1998.

TransUnion considered 1998 as a representative year of credit performance within the usual dynamic of the historical credit cycle. A value of more than 100 represents a higher level of relative risk. For comparison purposes, the Credit Risk Index in recent years has generally ranged between 110 and 120, experiencing a one- or two-point shift between quarters.

TransUnion's Trend Data Database
The source of the underlying data used for this analysis is TransUnion's Trend Data, a one-of-a-kind database consisting of 27 million anonymous consumer records randomly sampled every quarter from TransUnion's national consumer credit database. Each record contains more than 200 credit variables that illustrate consumer credit usage and performance. Since 1992, TransUnion has been aggregating this information at the county, Metropolitan Statistical Area (MSA), state and national levels.
www.transunion.com/trenddata

About TransUnion
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Attachment D

Free Consumer Credit Videos, Quizzes at TransUnion.com Focus on Key Aspect of Personal Finance: Managing Credit Health
DVD Version Offered to Help Educate Consumer Groups, Organizations
February 9, 2010

TransUnion, a global leader in credit and information management wants to help U.S. consumers get a better handle on how credit works, when they have access to it, and what their part is in that process. To do so, the company has introduced a credit education video series on its U.S. website entitled "Understanding Your Credit." The series features 5 topically-based segments, knowledge quizzes for each segment and informational links to related content at TransUnion.com. The videos can be accessed free of charge from that home page or directly at www.transunion.com/creditvideo

"The current economic climate has consumers more focused than ever on their credit standing, yet we're seeing that there's quite a bit about how credit works and the role individuals can play in keeping their own credit in good standing that many people just don't understand," said Mark Marinko, TransUnion President of Consumer Services.

After viewing a brief introduction, consumers can either let the full video program play straight through or opt to pause between segments in order to take brief credit literacy quizzes covering the content they've just watched. The quizzes provide feedback as well as a letter grade based on the knowledge consumers demonstrate about each section. A built in "share" feature makes it easy to invite others to view the material at their convenience. The five topical segments covered in the series are:

-- Credit Reporting and How Credit Works

-- Seven Steps to a Healthier Credit "Core"

-- Ensuring the Accuracy of Your Three Credit Reports

-- Fraud and Identity Theft

-- Credit Scores

"TransUnion has created a solid primer for a broad spectrum of consumers struggling through an economic crisis rooted, to a great extent, in financial illiteracy," said John Hope Bryant, Operation HOPE Founder, Chairman and CEO, Vice Chairman, U.S. President's Advisory Council on Financial Literacy and author of the new bestselling book, LOVE LEADERSHIP. "The video series promotes understanding and transparency around the key areas of credit -- what it is, how it impacts our lives -- and ultimately provides the kind of knowledge that can help families better navigate today's complex financial world."

A DVD version of the videos is also available upon request to groups seeking credit education-focused presentation materials for large audiences.

"We've tried to put ourselves in consumers' shoes," added Marinko. "What would we want to know about how credit works, and how would that knowledge help each of us better achieve our own personal life goals?"

About TransUnion

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Questions for The Honorable Sandra Braunstein, Director of the Division of Consumer and Community Affairs, Federal Reserve Board of Governors from Chairman Luis Gutierrez

1. Ms. Braunstein, as you know there is a concern that mortgage assistance programs may lower a consumer's credit scores. The alternative--foreclosure--would lower it even more. In your testimony, you say that the Fed is paying special attention to scoring systems that are used with the loss mitigation process and you state that institutions could develop credit scoring models that provide input into loss mitigation decisions, such as decisions to modify mortgages. Please explain what the Fed is doing in this regard and please explain what type of "input into loss mitigation decisions" you are referring to.

As my testimony mentioned, the Federal Reserve is giving special attention to scoring systems that are used within the loss mitigation process.

Many institutions use models at various stages of their loss mitigation decision process. Some institutions may use their own models for determining which loan modification options should be offered to borrowers. Institutions also may develop models to predict borrower delinquency. These models may be used to determine whether borrowers are contacted to discuss loss mitigation options. Credit scores may be an input into many of these models, along with other borrower and loan characteristics. These models, however, do not provide input into a consumer's credit score.

The Federal Reserve is committing to ensuring that the institutions it supervises comply with the fair lending laws during the loss mitigation process. We have been monitoring loss mitigation efforts and have initiated fair lending reviews involving loss mitigation. These reviews will include a review of the models that lenders use to guide loss mitigation decisions.

2. Do you support having the credit bureaus take into account and grant special consideration--in terms of what is reflected in their credit reports and in their credit scores--to those homeowners who, rather than abandon their homes or lose them to foreclosure, avail themselves of government loan modification programs such as HAMP (Home Affordable Modification Program)? Please respond and explain.

It depends what kind of "special consideration" is contemplated. Consistent with the observation made in Question 1, it is my understanding that today consumers who obtain government-sponsored loan modifications already receive more favorable treatment in credit bureau files and in credit scoring models than otherwise similar consumers who go through a foreclosure. This is appropriate because the consumer who obtains a modification demonstrates a willingness to pay, even though that consumer may lack the capacity to pay under the original terms of the loan.

On the other hand, consumers who avail themselves of government loan modifications clearly are having difficulty meeting their credit obligations and generally need to reduce the amount of their indebtedness. It is therefore appropriate to reflect this information in the consumer's credit report and credit score because it is relevant to evaluating that consumer's creditworthiness and credit capacity.

Suppressing accurate information about participation in government-sponsored loan modifications from credit reports and credit scores could have adverse consequences. First, it would reduce the accuracy and completeness of credit reports and potentially undermine the predictive power of credit scores. In addition, without this information, other creditors, such as credit card issuers and auto finance companies, may inadvertently extend to a consumer more credit than the consumer reasonably can repay. If so, the consumer may again become overextended and default on the modified mortgage, which would harm the consumer and negatively impact government loan modification programs generally.

3. The Fed and FTC recently issued risk-based rules which go into effect on January 1, 2011. Under certain circumstances, a creditor may disclose a free credit score to a consumer as an alternative to providing risk-based pricing notices. Even under the new rules, consumers will not be able to get so-call "proprietary credit scores" from creditors where the creditor includes additional information not contained in a credit report. Shouldn't we have a system where consumers are allowed to get a free credit score, especially the same score used by the creditor? Wouldn't that be a more equitable and transparent way for consumers to know what they are facing?

The risk-based pricing rules generally require creditors that follow the credit score disclosure option to provide a credit score used by the creditor. However, the rules do not require creditors to disclose "proprietary credit scores" that include additional information not contained in a credit report, such as information about a consumer's income, assets, debt-to-income ratio, and loan-to-value ratio.

The disclosure of proprietary credit scores would be confusing and unhelpful to consumers. Proprietary credit scores vary widely in terms of the information they consider, the relative significance of that information, and the score range. For example, a proprietary credit score used by a mortgage lender may consider factors such as income and loan-to-value ratio while a proprietary credit score used by an auto finance company may consider different factors, such as the amount of the down payment or the make and model of the vehicle being financed. Likewise, credit scores provided by credit bureaus generally use a standard scale, for example, FICO scores generally range from 350 to 850. In contrast, proprietary credit scores may use a far different scoring scale, for example, a scale of 1 to 10 or 1 to 100.

Based on available research and the Board's extensive testing of consumer disclosures, we know that disclosures must be kept simple in order to be understandable and useful for consumers. We also know that providing consumers with too much information can lead to information overload and consumer confusion, diminishing the value of disclosures. Given what we know about consumer disclosures generally, disclosing proprietary credit scores could make credit score disclosures more opaque, complicated, and confusing, rather than more equitable and transparent. For example, if proprietary credit scores were disclosed, a consumer who receives such a score would not know the extent to which his or her score was affected by information in the credit report, as opposed to additional information not contained in a credit report. Similarly, the disclosure of proprietary scores, with different scales and inputs, would not allow consumers to compare changes in their scores over time.

In addition, the purpose of the risk-based pricing rule is to alert consumers to possible errors in their credit reports. Given this purpose, it is more appropriate to provide consumers with credit scores derived solely from information in the credit report, rather than proprietary credit scores that take into account additional information. The disclosure of credit scores derived solely from information in the credit report makes it easy for consumers to determine whether there are problems with their credit report. By contrast, it would be difficult for consumers to know whether a low proprietary credit score resulted from information in their credit reports or from additional information obtained from other sources. For this reason, the disclosure of proprietary credit scores would be confusing and unhelpful in this context.

Finally, the approach taken in the risk-based pricing rules with regard to the disclosure of credit scores follows the approach that the Congress itself has adopted in other parts of the Fair Credit Reporting Act (FCRA). The Congress has mandated credit score disclosures in Sections 609(f) and (g) of the FCRA. Each of these provisions makes clear that the disclosure of proprietary credit scores is not required to satisfy the statute's requirements.[1]

4. There are some troubling findings in the Fed's 2007 report to Congress on credit scoring. For instance, the Fed's study found that African-Americans appear to incur higher interest rates on automobile and installment loans that do non-Hispanic whites. Yet the Fed concluded that the credit characteristics included in credit history models do not serve as substitutes, or proxies, for races, ethnicity, or sex. This disparate impact on minorities remains of concern. Could you explain the limitations in the Fed's model and the key differences between the Fed's model and the models used to by credit reporting companies?

To prepare the Federal Reserve's August 2007 Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit, Federal Reserve researchers estimated a generic credit scoring model using an algorithm that mimicked to the extent possible the process used by commercial model builders estimating bureau-based credit scores, that is, scores based solely on credit record information. The data used to estimate the models are essentially the same and the statistical procedures used to construct the model are very similar. Of course, the specific credit record sample used to estimate models differs due to the number of credit records chosen for estimation and validation purposes and the date selected for the drawing of the credit record sample.

The report found differences in average interest rates paid across groups for automobile and installment credit after controlling for credit score. As the report stated, these differences cannot be fully explained by the data available for the report. However, loan pricing considers many factors related to the item being purchased (such as the age of the vehicle or loan-to-value ratio) or the consumer (such as the consumer's income or debt-to income ratio) that are not included in

[1] Specifically, section 609(f) of the FCRA requires consumer reporting agencies to disclose credit scores to consumers, for a fair and reasonable fee, upon the consumer's request. However, the statute provides that a credit score does not include a mortgage score or rating of an automated underwriting system that considers factors in addition to credit report information, such as income or assets. Section 609(g) of the FCRA requires the disclosure of credit scores to consumers, without charge, in connection with mortgage loan applications. The statute provides that a creditor that uses a proprietary credit score need not disclose such score, but may provide a credit score supplied by a consumer reporting agency.

credit records. Also, credit record information does not indicate whether an installment loan is secured or not. These essential elements of loan pricing may explain the differences in rates of interest observed on the report.

Discrimination could also be a factor. The potential for discrimination in automobile lending, for example, is heightened because these transactions frequently involve in-person dealings between the creditor and the consumer, and loan pricing is often not based solely on credit scores and other objective information. Instead, automobile dealers may have discretion and financial incentives to increase consumers' interest rates. Detecting such discrimination is an involved process that requires consideration of all the relevant factors that can result in pricing differences across groups. Detecting discrimination was not possible in this study. However, in the Federal Reserve's role as a supervisor, we do fair lending reviews that can detect discrimination. In 2007, for example, we referred a lender to the Department of Justice for auto pricing discrimination. This referral led to a Department of Justice settlement with Nara Bank.

Correction to Prepared Statement:

For the record, we would like to make one correction to the Statement of Sandra F. Braunstein (March 24, 2010). On page 7, it states that credit scoring is used to facilitate decision-making in areas other than credit, including insurance, housing, *and employment*. While there is no legal prohibition on using credit scoring for employment purposes, it is our understanding that credit bureaus as a matter of practice do not provide credit scores to persons requesting credit reports for employment purposes, but only provide credit reports for such purposes.

VANTAGESCORE®

May 3, 2010

Thomas G. Duncan
General Counsel
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Duncan:

I am pleased that VantageScore was able to participate in the March 24th hearing held by the House Financial Services Subcommittee on Financial Institutions and Consumer Credit entitled: "Keeping Score on Credit Scores: An Overview of Credit Scores, Credit Reports and their Impact on Consumers." Below are responses to the questions that you forwarded to me on behalf of Chairman Gutierrez and Representative McCarthy following the hearing:

Responses to Questions from Chairman Gutierrez

Q1. Mr. Burns, you mention in your testimony that there are hundreds of different credit scores being used in the marketplace today. Is there a score for employment screening purposes?

A1. Although a score for employment screening could exist, I am not aware of such a score. VantageScore Solutions, LLC is an independently managed firm that holds the intellectual property rights to VantageScore, a generic consumer *credit* score model developed by the nation's three major credit reporting companies (CRCs) -- Equifax, Experian and TransUnion.

Q2. If there is a score for employment purposes, what criteria do you use to compile this score? What criteria do the users of these scores add to them once they receive them from you?

A2. The VantageScore model was developed for consumer credit scoring and is the only service managed by my company. We do not have a score developed for employment screening.

Q3. What do you do differently from FICO to increase the number of "scoreable" consumers?

A3. I should note that we have never compared VantageScore to FICO due to contractual limitations imposed on our owners by FICO. That said, it's well known in our industry that many long-time

models in the marketplace employ criteria in their algorithm that wind-up excluding people from obtaining a score. These criteria include requiring consumers to have a credit file history of greater than six months and where the most recent tradeline activity is not older than six months.

During the development of VantageScore, proprietary and sophisticated analytical techniques were incorporated into the algorithm. As part of that development, the scientists responsible for building VantageScore chose to change the criteria in our model, such that we provide scores for people whose credit history is as short as one month. In addition, we look back further into the credit file, providing a score for people whose most recent activity is as old as 24 months.

The following excerpt from pages 5 and 6 of our written testimony provides additional information that is responsive to your question:

> Millions of consumers can't obtain a credit score under some traditional models. The predictive power of VantageScore enables lenders to find more creditworthy consumers while maintaining accuracy in risk assessment. With this capability, VantageScore plays a vital role in making the mainstream credit markets more accessible to creditworthy consumers at appropriate rates and terms. Lenders can achieve higher volumes and more market share without lowering their credit standards and exposing their portfolios to undue risk, while keeping such consumers away from predatory lenders.
>
> Through our analysis, VantageScore has identified three categories of consumers who face difficulties accessing mainstream credit markets because they are unable to obtain a score: "Thin file", "infrequent credit user" and "new entrant."
>
>> **Thin File.** 'Thin File' commonly means "consumers with fewer than three accounts in their credit file." It is estimated that between 35 and 50 million adults in the United States – equivalent to 18 to 25 percent of the adult population – may be considered thin file. A significant number of consumers thus may be blocked from mainstream credit or incorrectly priced because lenders are unable to leverage their standard decisioning strategies with these populations. The analytical approach in the VantageScore model provides lenders with access to a larger pool of scoreable consumers while maintaining accuracy in risk assessment.
>>
>> **Infrequent Credit User.** The infrequent credit user is a person who may not be eligible for a score because there has not been new activity on any credit account for six months. VantageScore, however, will reach back deeper into the consumer's credit history to provide a score. These could be people who have a long and favorable credit history, but they no longer use credit because they prefer to pay in cash.
>>
>> **New Entrant.** As the name suggests, a new entrant is just establishing credit relationships and has not had credit open for more than the six months that

VANTAGESCORE

some traditional models require in order to produce a score. Unlike these other credit scoring models, VantageScore will score new entrants to the credit market.

Individuals typically falling into the three categories above include:

- Young adults just starting their careers
- Recently divorced or widowed individuals with little or no credit in their own name
- Newly arrived immigrants
- Previous bankrupts
- People who shun the traditional credit products by choice
- People who have been prudent with fiscal management in their early years, perhaps paid off all debts and now use credit sparingly
- Possibly minorities. According to the National Council of LaRaza, 22 percent of Latinos have thin credit files or no credit files.

The implicit assumption is that a consumer without a credit score equates to high risk. VantageScore's ability to provide scores for many thin file consumers, infrequent credit users and new entrants allows lenders to better distinguish between good credit quality consumers and those with a clear track record of unfavorable credit behaviors. A sparse credit history and/or its lack of alignment with the data specifications of common scoring models is not necessarily a reflection of poor debt management behavior.

A comparison of VantageScore with a traditional CRC scoring model that used a random sample of mortgage customers saw an overall increase in scored consumers with VantageScore of 8.1 percent, equating to some 10 million consumers. Additionally, 2.5 million consumers from the study were more accurately indentified as higher credit quality than subprime – likely moving them away from the higher priced subprime products.

Population of consumers with a mortgage trade-line and valid risk scores

Experian Risk Score score intervals	VantageScore scored population	Experian Risk Score scored population	Percent Increase
< 840	37,200,879	35,650,730	4.3%
< 710	20,770,817	19,222,143	8.1%
< 690	18,905,850	17,361,704	8.9%
< 660	16,443,381	14,992,740	9.7%
< 675	14,743,723	13,403,763	10.0%
< 645	13,008,548	11,738,798	10.8%
< 620	11,968,160	10,746,894	11.4%
Total	133,041,358	123,116,772	8.1%

Source: Experian, VantageScore Addresses Deficiencies in Traditional Scores in the Subprime Consumer Sector, (May 16, 2007), p. 2

VANTAGESCORE

Q4. Are there any data sources that would make your formula better and that you would like to have access to, such as NCTUE (National Consumer Telecom & Utilities Exchange, Inc.) data? If so, would you be interested in negative or late payment data s well as on-time payment date, or just negative or late payment data? If you are interested in both, would you use them in the VantageScore method? Please respond and explain.

A4. We are always interested in testing and analyzing new data sources to determine its predictive value in the calculation of a consumer credit score. Both positive and negative history is needed in order to provide a full picture of consumer behavior. The methodology for inclusion in VantageScore would be determined based on the testing we conduct on these new data sources and is dependent on the data's overall quality, including but not limited to the data's accuracy and breadth of reporting, integrity and uniqueness.

Response to Question from Representative McCarthy

Q: Panel 1: Pratt, Quinn, Burns, Wiermanski, Oliai, Hart:

Many credit card companies offer payment plans to those customers who have an extended balance that is carried over monthly. It has come to my attention, that some credit card companies, are considering a customer who enters into a payment program as "delinquent" in paying their monthly bill, even though they are paying an amount that was calculated for them by the credit card company. Customers are not aware that they considered delinquent, and are only finding out when they run their credit report, and it shows them as "delinquent" for the entire time period that they were participating in the "suggested" payment plan, and their score has declined significantly because of this mark against them.

- Are there codes or attributes that are assigned for individuals in payment plans that reflect the individual is in fact making a monthly payment?

If the answer is no, then:

- How do you suggest we make this important distinction ---between being in a payment program, and actually just being delinquent?

- In a proactive effort to avoid identity theft and ensure accuracy of items added to credit reports, perhaps a notification process should be established, that would notify an individual when a credit rating agency is adding a new item to their report? How would you envision your entities implementing that notice?

A: VantageScore Solutions, LLC is an independently managed firm that holds the intellectual property rights to VantageScore, the consumer credit score developed by the nation's three major credit reporting companies (CRCs) -- Equifax, Experian and TransUnion. As such, we are not a credit reporting company, and therefore do not receive consumer payment data from lenders. The Consumer Data Industry Association (CDIA) represents the consumer credit

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reporting information industry and is comprised of credit reporting agencies, mortgage reporting companies, collection services companies, check services companies, tenant screening companies and employment reporting companies. CDIA works with its membership to set industry standards, including the Metro 2 format – the data standard for lenders that report consumer payment history to credit bureaus. CDIA is a good source for an accurate answer to this question.

If you have any further questions or would like additional information please don't hesitate to contact me or our Washington Counsel, Bill Donovan, at (202) 344-4939.

Sincerely,

Barrett Burns
President & CEO

VANTAGESCORE.

May 3, 2010

The Honorable Mary Jo Kilroy
U.S. House of Representatives
Washington, DC 20515

Dear Representative Kilroy:

Thank you for your on-going interest in credit scoring issues; I appreciated your active involvement in the March 24th hearing held by the House Financial Services Subcommittee on Financial Institutions and Consumer Credit entitled: "Keeping Score on Credit Scores: An Overview of Credit Scores, Credit Reports and their Impact on Consumers." Below are responses to the questions received from your staff following the hearing:

Q1. What percentage of your data is reported directly by medical businesses (ie hospitals, physicians, ambulance companies, dentists, etc) as opposed to third-party collection agencies?

A1. VantageScore Solutions, LLC is an independently managed firm that holds the intellectual property rights to VantageScore, the consumer credit score developed by the nation's three major credit reporting companies (CRCs) -- Equifax, Experian and TransUnion. VantageScore Solutions itself is not a credit reporting company, and as such, we do not receive consumer payment data from any business, including medical businesses and third-party collection agencies. Therefore, we are not able to answer this question. We recommend contacting one or more of the credit bureaus for an answer.

The VantageScore algorithm does not utilize medical payment data in generating consumer scores, when the reporting comes directly from the medical provider.

We do receive anonymous consumer credit files provided by the credit reporting companies for calibration and validation of our algorithm, but these files do not contain medical trade data.

The VantageScore algorithm does include all collections trades when generating a score, including third-party collections activities related to medical debt. However, the algorithm is impartial to the various type of collections debt, that is, medical collections trades are not distinguished from any other kind of collection trade when we calculate a consumer score. All collections trades are treated the same way in the algorithm. Once paid, collections trades are no longer considered in a VantageScore credit score.

VantageScore Solutions, LLC 281 Tresser Blvd., Suite 1002 Stamford, CT 06901 T: 203.363.2160 VantageScore.com

VANTAGESCORE

Q2. Is it typically the case that medical accounts are not reported unless they are categorized as delinquent, then assigned to collection and reported?

A2. No – It's our understanding that when medical tradelines are reported to the bureaus, the reporting is both positive and negative. When medical debt enters collections, the collections agencies are required to report and identify medical debt separately from other collections debt.

The caveat is when a consumer has paid a medical bill with a credit card. If the credit card becomes delinquent and then goes to collections, the debt is identified as a credit card debt. In that event, a credit score algorithm has no way to distinguish the underlying transactions related to that credit card, such as separating a store purchase from a paid medical expense.

Q3. Do your credit score algorithms weigh medical debt differently from other forms of debt? If so, do they have more or less influence over one's credit score?

A3. VantageScore does not consider medical trades themselves in the calculation of our score.

Q4. Do your credit score algorithms weight medical debt accounts that have been reported by collection agencies (as opposed to medical providers) differently from other forms of debt in the credit history section of the credit score?

A4. No. As stated in response to Question One, if a medical trade goes to a third-party collections agency and is reported to the bureaus, our algorithm will pick-up and consider that collections account. But, all collection debt is considered in the same manner; medical collections are not treated differently.

Q5. One study published in the Fed Reserve Bulletin found that over half (52%) of non-credit accounts in collection in collection are medical

a. Is this figure consistent with your data?
b. Do you know the median balance of medical payment data trade lines?
c. Do you currently continue to report medical payment trade lines in the credit history section that have a zero balance?
d. Do you have data on consumer requests for verification of medical account trade lines that appear on credit reports and comparative data for other types of accounts or trade lines?

A5. VantageScore Solutions has no access to the data needed to answer items a, b or d. Please see our response to Question One for item c.

VANTAGESCORE

Q6. Do you consider medical debt trade lines to be of good predictive value of overall credit worthiness? Please explain.

A6. No. Our understanding is that there are approximately only two million medical tradelines within the total database of 3.4 billion tradelines. Significantly fewer medical collections accounts exist. In our opinion, this is not enough data to use to effectively model consumer behavior. Put another way, we don't believe that medical debt will contribute to predictive performance.

Q7. Credit score simulation services that have been used to remove recent low balance or zero-balance medical trade lines from a credit report have shown that two or three of these accounts can lower a credit score by 50-100 points. Do you believe this is accurate and that even accounts with a low or zero balance can have such a significant effect on a credit score? Please explain.

A7. Without access to the simulation study and underlying data, there is not enough information to make an accurate assessment to respond to your question. Because our algorithm does not include medical trades in the calculation of our score, we do not have a need to conduct such studies ourselves. Additionally, as noted in our response to Question One, we also don't have access to the data needed to conduct this kind of a test and therefore can't compare your results to anything we've done.

If you have any further questions or would like additional information please don't hesitate to contact me or our Washington Counsel, Bill Donovan, at (202) 344-4939. Incidentally, while VantageScore Solutions' headquarters are in Connecticut, I frequently travel to Washington and would very much enjoy meeting with you to discuss these and related issues at your convenience.

Sincerely,

Barrett Burns
President & CEO

U.S. House of Representatives Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

March 24, 2010 Hearing
"Keeping Score on Credit Scores: An Overview of Credit Scores, Credit Reports, and Their Impact on Consumers."

Questions from Chairman Gutierrez for Anne Fortney, Hudson Cook LLP

1. Ms. Fortney, in your testimony you say that it is "neither efficient nor fair to focus on individual circumstances in an underwriting system that is designed to predict risk for an entire population" and you criticize proposals to restrict the use of medical debts and student loan information in credit reports. Since you dismiss these proposals due to your concerns about the "unfairness" of focusing on individual circumstances, do you really consider it "fair" to have medical debt that's been paid off after a collection agency intervenes on your record for up to 7 years? Please respond and explain.

   Answer: As I testified, I believe that credit scoring is fair for all consumers because it is objective and neutral. In addition, credit scoring is fair because it has helped more consumers obtain credit at lower prices. The nature of credit scoring prevents the consideration of any individual's circumstances or characteristics, and creates the most objective credit evaluation system. In our nationwide consumer credit industry, creditors do not know the people whose risk they evaluate. Credit scoring systems predict risk and enable creditors to extend credit to total strangers.

   The removal of any predictive characteristic makes a credit scoring system less predictive and, therefore, less able to help consumers obtain credit. For that reason, the removal of a predictive factor like a medical collection would be fundamentally unfair to consumers. Moreover, as the Fair Isaac witness testified, credit scoring systems generally consider only medical collection information, not a medical bill that is paid on time. When consumers do not pay their bills for a period of time that results in the bills being sent to collections, those consumers pose a greater risk of default, and creditors need to have that information in order to predict risk.

   Finally, the FCRA seven-year limitation applies to all collections equally (with an additional time for bankruptcy). Thus, it is fair for a medical collection, or any other collection item, to remain on a consumer's credit report for 7 years. Credit scoring systems also consider the age of information in a consumer's report, so that the older the medical collection item, or any other collection item, the less weight it will be given and the less negative effect that item will have on the consumer's credit score.

2. Medical debt collections are often based on erroneous and inaccurate information and many consider them of questionable predictive value in terms of future payment performance. Why shouldn't credit bureaus eliminate paid off medical debt from a consumer's credit report, even if it paid off shortly after a collection agency intervenes and particularly since it currently stays in credit reports for up to 7 years?

   Answer: I am aware of no independent, empirical study of medical debts that casts doubt on the accuracy of this information, and I caution against the elimination of any predictive characteristic in credit scoring systems based on vague accounts or anecdotal stories. It would be inappropriate and counterproductive to require credit bureaus to make a subjective decision about the validity of any debt, even medical debts, or to assume that one type of debt is more likely to be erroneous than any other type of debt.

   Every entity that furnishes information – including medical care providers and collection agencies that collect on behalf of medical providers – is required by the Fair Credit Reporting Act to report accurate information to the credit bureaus. If a consumer believes that information about a medical debt is erroneous, the consumer has the right to dispute the information with the furnisher in two ways (1) through the credit bureau reporting the information and (2) directly with the person who furnished the information. If the information cannot be verified, it must be deleted. If it is incorrect, it must be updated. If it is verified as accurate, it will continue to be reported. If, after the dispute is resolved the consumer still believes that for some reason the debt is not owed or should not be reported, the consumer can place a comment on his or her credit report explaining the dispute.

   Moreover, if the furnisher is a debt collector seeking payment on a medical debt on behalf of the furnisher, the consumer has additional rights to dispute the validity of the debt under the Fair Debt Collection Practices Act. Therefore, there is no reason to single out one type of debt from another.

   Based on my experience, I know that the more information that is available for a creditor to consider, the better the risk assessment. Requiring credit bureaus to single out and delete a particular type of debt creates a dangerous precedent for others to argue that other types of debts are not predictive. Moreover, if medical debt were not predictive, then credit score developers, armed with statistical data, could create the most accurate scoring models taking into account factors that have proven to be or not to be predictive of future behavior.

3. As you know, credit card companies have been lowering credit limits on consumers, often regardless of the consumer's payment history. This has a serious impact on a consumer's credit score, again, even if the consumer's payment history or credit usage is unchanged. Yet, in your testimony you say that "One would expect minimal impact on the affected consumer's credit scores" if the lowering of credit limits simply reflects an awareness that high credit limits are inconsistent with current economic conditions. From the testimony given at the hearing, it seems that instead

of a minimal impact, the lowering of credit limits in the above explained circumstances has a significant impact. Please respond and explain.

Answer: As explained at Fair Isaac's website, myFICO.com, a consumer's payment history is only one category of the factors that have been proven to predict risk in credit scoring systems. Therefore, it is incorrect to assume that a consumer's credit score, and thus level of risk, should be determined only by payment history.

I do not believe that the testimony at the hearing indicated that the lowering of credit limits has had a significant effect on the credit scores of most consumers. Lowering credit limits would have a significant impact only if the consumer's credit utilization placed the consumer near the revised credit limit, and there is no indication that most consumers are in that situation. According to myFICO.com, the typical consumer has access to approximately $19,000 on all credit cards combined. More than half of all people with credit cards are using less than 30% of their total credit card limit. Just over 1 in 7 (about 15%) are using 80% or more of their credit card limits. This statistic confirms that lowering credit limits would have a minimal effect on most consumers' credit scores.

4. In relation to the previous question concerning credit card companies and the impact of lowering credit limits on a consumer's credit score, as you defend the current system and the "predictability" of credit models and scores, could you explain your defense of a system that significantly impacts a consumer's credit scores simply due to changing economic conditions regardless of payment history and credit usage?

Answer: It is inaccurate to state that credit scores are being affected by changing economic conditions rather than consumers' payment histories and credit usage. In fact, along with payment history and other factors, credit usage determines a consumer's credit score. Consumers who are using most of their available credit in the first place are those for whom lowered credit limits could have a measurable negative effect on their credit scores. That result is appropriate and fair because credit utilization has been shown to predict risk and is an important factor in credit scoring models.

If after an account review, a creditor decides to lower the credit limit on certain customers for risk reasons, this action would alert other creditors to the fact that there is a higher risk when a consumer applies for new credit. Moreover, under the new CARD Act rules, creditors will have additional obligations with respect to reversing a credit line reduction under certain circumstances.

Respectfully submitted,
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Make every decision count.™

May 10, 2010

The Honorable Luis Gutierrez
Chairman
Subcommittee on Financial Institutions
and Consumer Credit
U.S. House of Representatives
2266 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Gutierrez:

I am writing in response to questions forwarded to me by General Counsel Thomas Duncan following my testimony on credit score-related issues before the House Financial Institutions and Consumer Credit Subcommittee on March 24, 2010. Below, please find my replies to the questions outlined in Mr. Duncan's correspondence:

Chairman Gutierrez:

1. **Why don't you or the bureaus that buy your score offer private citizens the opportunity to purchase the credit scores that lending decisions are actually made from?**

   The FICO® score is the credit score used by most lenders to make decisions. For nearly 10 years, FICO has made the FICO® score available to private citizens on myFICO.com.

   Since 2001, myFICO.com has served as the primary destination for consumers who wish to understand and obtain their FICO® scores. During this period, myFICO and affiliates have provided more than 27 million FICO® scores to consumers. This total includes FICO® scores sold by Equifax, a credit bureau partner, which makes them available to consumers on Equifax.com. For a modest fee, consumers gain access to the same credit scores that are most widely used by lenders—a FICO® score. The information provided includes the FICO® score, the underlying credit report on which it was generated, a detailed explanation of the score, the score range, a distribution chart that indicates where the consumer stands among a national distribution of consumer credit scores and the primary reasons why the score was not higher. Also, without making any purchase, consumers can access myFICO.com to learn about the FICO® score, what factors affect one's FICO® score, and what steps one can take to improve their FICO® score.

2. **Mr. Quinn, much of the FICO score is based off payment history information and availability of credit, especially revolving credit. Say someone has all their bills paid off, rents an apartment, doesn't have a car and has no revolving debt but has quite a bit of money in the bank. Would this person be viewed as a significant credit risk under your formula? How do you accurately score someone who does not regularly use revolving credit?**

   It is difficult to characterize whether or not a consumer is a significant risk because that ultimately depends on an individual lender's tolerance for risk. In general, the type of consumer in question can score well, greater than 700, assuming they have an established credit history with recent activity. How the consumer ultimately scores will depend on their comprehensive credit history. Please note that a FICO® score is based solely on information contained in a person's credit report. Bank account balances are not captured on the credit report and are not a factor considered by the FICO® score algorithm.

FICO® scores are rigorously audited to ensure that the score delivered to lenders and consumers is accurate. Even though a consumer may not have any revolving debt, the FICO® score will leverage other information on the credit report to accurately assess the risk of the consumer based on the available information.

3. **Is the FICO Expansion score that you mentioned in your testimony used for making lending decisions by your institutional customers? Do you sell or market it in this way? How many lenders purchase this score?**

   The FICO® Expansion® Score is currently available to lenders with a permissible purpose to be used in their credit granting decisions. The FICO® Expansion® Score is marketed to lenders as a score that gives lenders the ability to assess the credit risk of customers who have little or no credit history at the three major US credit bureaus. We generally do not make public customer-related information, but we can say that hundreds of lenders have accessed FICO® Expansion® Scores in their credit decision processes since the service was first made available in the fall of 2004.

Representative Carolyn McCarthy:

Many credit card companies offer payment plans to those customers who have an extended balance that is carried over monthly. It has come to my attention, that some credit card companies, are considering a customer who enters into a payment program as "delinquent" in paying their monthly bill, even though they are paying an amount that was calculated for them by the credit card company. Customers are not aware that they considered delinquent, and are only finding out when they run their credit report, and it shows them as "delinquent" for the entire time period that they were participating in the "suggested" payment plan, and their score has declined significantly because of this mark against them.

- **Are there codes or attributes that are assigned for individuals in payment plans that reflect the individual is in fact making a monthly payment?**

  If the answer is no, then:

- **How do you suggest we make this important distinction—between being in a payment program, and actually just being delinquent? In a proactive effort to avoid identity theft and ensure accuracy of items added to credit reports, perhaps a notification process should be established, that would notify an individual when a credit rating agency is adding a new item to their report? How would you envision your entities implementing that notice?**

  Since FICO is not a consumer reporting agency, we are unable to comment on how information is specifically reported by lenders or how the consumer reporting agencies might address the differentiated coding issue you raise.

I appreciate the opportunity to respond to the above questions.

Sincerely,

Thomas J. Quinn
Vice President

QUESTIONS FROM CHAIRMAN GUTIERREZ

Q1. Mr. Vladeck, when the FTC issued its 2007 report on credit-based insurance scores and its impacts on consumers of automobile insurance, Commissioner Pamela Jones Harbour dissented from the report since she disagreed with the methodology you used. The FTC is still in the process of gathering information for its long-overdue report on credit-based insurance scores and its impacts on homeowners insurance. Have you taken steps to take into account the specific concerns of Commissioner Jones Harbour as you prepare the report on homeowners insurance? Please explain.

A. Yes. According to staff from the FTC's Bureau of Economics, we have taken substantial steps to address Commissioner Harbour's concerns. It is my understanding that her primary concern with the 2007 report was that it relied, in large part, on a database of automobile insurance policies that had been submitted voluntarily by five anonymous insurance groups. In her dissent, Commissioner Harbour stated that the Commission should have chosen which insurance firms were to provide data and used its authority under section 6(b) of the FTC Act to compel those firms to provide data directly to the Commission. Others, including Congressmen Frank, Gutierrez, and Watt, expressed the same sentiment in a letter to then-Chairman Majoras. In the current study we addressed Commissioner Harbour's concerns by issuing 6(b) orders to compel the provision of data from the nine largest homeowners insurance groups. I believe this will also give others greater confidence in the current study as well. The insurance groups have provided information about all of their owner-occupied, single-family homeowners policies for a three year period directly to the Commission; this data will form the basis of the Commission's study of homeowners' insurance.

Q2. Please explain the difficulties the FTC has encountered with the insurance companies as in the process of gathering information for its report on homeowners insurance. Is the FTC satisfied with the extent and accuracy of the information collected from the insurance companies? Please describe the next steps the FTC will take in preparing this report and when we should expect the report to be completed.

A. It has taken some time to gather the data from the insurance companies because first, we needed to determine what information would be most useful for the study and second, we had to negotiate how the insurance groups would produce their data to the FTC. For a period of time, it appeared the FTC would have to take the insurance groups to court to compel compliance with the 6(b) orders, but fortunately we avoided court proceedings and the substantial delays that would have accompanied such proceedings. Also, there have been a few technical difficulties in the process of receiving information, but this is to be expected in an undertaking as large and complex as this one.

The FTC is using its 6(b) authority to compel the nine largest insurance groups to provide the data it needs for the study. After a period of notice and comment relating to what the Commission would require the insurance groups to produce under its 6(b) Orders, the Commission issued Orders to File Special a Special Report in December 2008. The Commission issued Subsequent Modified Orders in March 2009. The Modified Orders

addressed some technical issues with the original orders, including eliminating certain subsidiaries to some of the insurance companies that the Commission had not intended to cover with the initial orders. The Modified Orders also addressed concerns both the FTC and the insurance groups had about the amount of personally identifiable information (PII) that would be transmitted for the study. A large portion of the negotiations for producing data covered how the insurance groups and the FTC would protect consumers' PII. The Modified Orders codified that negotiated procedure.

As of October 2009, all nine groups had submitted the data requested by the Orders, with the exception of the PII. This consists of detailed data on approximately 47 million policies and 15 million price quotations and applications. Commission staff have completed an initial review of the data to check for gross errors in the compilation or transmission of the data. The same staff are now undertaking a detailed analysis of the data for errors, inconsistencies, or other problems that would need to be addressed before the data can be used for analysis.

It will take several more months for the Commission staff to complete their review of the data and select a sample from the 47 million policies. The PII of the sample will then need to be transmitted to our contractors, who will match the PII to their databases and provide us with credit-based insurance scores, credit history information, and race, ethnicity, and other information. The FTC will then promptly analyze the data and prepare our report.

Q3. Some consumer advocates – such as Mr. Evan Hendricks who testified at the March 24th hearing – have complained that the public doesn't even know how many credit bureaus there are. They recommend that all credit reporting agencies, regardless of size, should register with the FTC and that the FTC should then publish an update a list [sic] of operating credit reporting agencies. Do you support this proposal?

A. The Commission has not taken a position on this proposal. I agree that, beyond the three nationwide credit bureaus, the public is not well-aware of what consumer reporting agencies (CRAs) exist. The Commission has brought enforcement actions against a number of such "non-traditional" CRAs, in part to highlight the breadth of entities covered by the FCRA. This is a question that we will continue to explore.

Q4. Even with recent rules providing for greater transparency and accuracy, are you satisfied that your agency has done enough to educate consumers about misleading ads like "FreeCreditReport.com" which appear to provide "free" credit reports when, in fact, they are not free if the consumer tries to obtain them through such sites?

A. Since the issuance of the Free Credit Report Rule, the FTC has made extensive efforts to address the proliferation of confusing advertising regarding where consumers can obtain their free annual credit reports. First, the Commission has released extensive consumer education materials on this subject. Second, the Commission has issued public warnings

about "imposter" sites that pose as the official free report site, AnnualCreditReport.com. Third, we have created videos that highlight the differences between the official site and other sites that claim to offer "free" reports. These videos are available at ftc.gov/freereports and on our YouTube channel.

In addition, the Commission's recent amendment to the Free Credit Report Rule will require prominent disclosures on all commercial offers of free credit reports designed to prevent consumers from confusing these "free" offers with the federally mandated free annual file disclosure available through the official site. This amendment should significantly help to educate consumers about their rights. Moreover, the FTC will monitor and evaluate the effectiveness of the disclosure required under the final Rule and will consider additional changes as necessary to ensure that the disclosure is prominent and understandable.

Finally, the FTC has brought enforcement actions to combat misleading advertisements related to free credit reports. The Commission will continue to scrutinize offers for free credit repots on a case-by-case basis to determine whether such offers are unfair or deceptive under section 5 of the FTC Act.

QUESTIONS FROM REP. CAROLYN MCCARTHY

Q. How will the rules being used in early summer, streamline the dispute process for consumers so that it is more efficient and timely?

A. Under the new Direct Dispute Rule, which will take effect on June 1, 2010, consumers will have the right to dispute information directly with the furnisher that provided that information to the CRA. Currently, the FCRA only gives them the right to dispute information with CRAs. Under the new Rule, once a furnisher receives a dispute from a consumer, the furnisher will have 30 days to complete the investigation and report the results back to the consumer. In many circumstances, this should be the quickest way to resolve a dispute, because the consumer can communicate information and any supporting documentation directly to the furnisher, and the furnisher will respond directly back to the consumer.

Q. Under current rules, when an individual is disputing an item, is there a code or anything else added to their credit file/report to indicate they are going through the dispute process, and if not, is this something that will be included in the new rules being issued?

A. If a consumer disputes information with a furnisher, the FCRA requires the furnisher to note the dispute when reporting that information to a CRA. The FCRA further requires the CRA that receives the information with the note of dispute to indicate on the consumer's report that the information is disputed. The future rules will not change either of these obligations.

QUESTION FROM REP. JACKIE SPEIER

Below is a follow up response in writing to the question asked by Representative Speier at page 108 of the transcript.
[the question was "To you, Mr. Vladeck, I do not think there is any teeth in the re-investigation requirements under the FACT Act or the original Act. Do you concur in that and if you do, what should we do to make sure re-investigation does take place?"]

A. I understand that some consumers may experience difficulties in disputing information on their credit reports and obtaining the right results. The FTC expects the Furnisher Rules, which take effect on July 1, 2010, will have a substantial impact on the ability of consumers to dispute information in their credit reports effectively. Consumers will have the ability to dispute information in their credit reports directly with furnisher, and will continue to be able to dispute information through the CRAs as well.

In addition, the Commission has taken several enforcement actions to ensure that CRAs and furnishers are complying with their accuracy and dispute-related responsibilities under the FCRA. For example, this past March, the Commission settled an action against a nationwide debt collector that, among other things, failed to investigate disputes referred by CRAs and failed to inform CRAs that consumers had disputed debts.

The Commission will continue to monitor the performance of the dispute process to explore possible improvements in the system and will bring law enforcement actions when warranted.

QUESTION FROM REP. KILROY

Below is a follow up response in writing to the question asked by Representative Kilroy
[the question was " When you take a look at the scoring systems that the various credit reporting agencies use in order to determine whether or not they are using a proxy that would have a discriminatory impact, have you taken a look at such issues as whether or not everyone in a particular Census track is penalized with their credit scores based on the number of foreclosures in the area, or looked at other kind of micro-targeting issues that a credit scoring company might utilize as many direct mail and other kind of marketers do? Even politicians use micro-targeting these days.]

A: I am not aware of any credit scoring models that use geographic information as described in your question.

Robert F Ryan
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April 23, 2010

House of Representatives
Financial Services Committee
Attention: Terrie Allison
2129 Rayburn House Office Building
Washington, DC 20515

To Whom It May Concern:

Here are the TransUnion responses to the Committee's follow up questions posed to Mr. Chet D. Wiermanski, in connection with his testimony at the March 24, 2010 hearing entitled, "Keeping Score on Credit Scores: An Overview of Credit Scores, Credit Reports, and Their Impact on Consumers."

Also, we attach page 59 of the transcript, in which we make a small addition to line 1255, adding the words "the current versions of".

These questions were posed by Rep. Gutierrez:

1. Please explain how, if at all, are TransUnion's "educational scores" used by lenders. RESPONSE: Although score disclosures to consumers can serve an educational purpose in terms of financial literacy, at TransUnion we do not use the term "educational scores". As Mr. Wiermanski testified at the March 24 hearing, all of the scores that TransUnion makes available to consumers (VantageScore and TransUnion proprietary scores) are used by lenders in production, as part of their credit decision-making process.
2. Do all major credit card companies and mortgage lenders have in-house supplemental scoring models? Of the credit card and mortgage companies, which are clients of TransUnion and which have in-house supplemental scoring models? Could you explain how these in-house supplemental scoring models differ from TransUnion's scores? RESPONSE: To the best of our knowledge, most lenders—not just credit card companies and mortgage lenders—apply internal calculations, independent of the generic risk score they receive from the consumer reporting agency, to their decision-making process. TransUnion provides services to most if not all of the credit card and mortgage companies in the United States. Internal models often use application and loan-specific variables and other factors, often unique to a specific lender, that are unknown to the consumer reporting agencies—it is in this sense that the two types of scoring processes differ.

These questions were posed by Rep. McCarthy: Many credit card companies offer payment plans to those customer who have an extended balance that is carried over monthly. It has come to my attention that some credit card companies are considering a customer who enters into a payment program as "delinquent" in paying their monthly bill, even though they are paying an amount that was calculated for them by the credit card company. Customers are not aware that they [are] considered delinquent, and are only finding out when they run their credit report, and it shows them as "delinquent" for the entire time period that they were participating in the "suggested" payment plan, and their score has declined significantly because of this mark against them.

1. Are there codes or attributes that are assigned for individuals in payment plans that reflect the individual is in fact making a monthly payment? RESPONSE: Yes, there are several remarks codes used to reflect when an individual is making payments under a modified payment plan. Often the presence of these codes is considered adversely by scoring models. There are a variety of reasons this may be considered adverse information. For example, a modified payment plan is a strong indication that the individual was unable to meet the original terms of the loan. It could also be that the lender is receiving less than the full amount of the original monthly payment. The delinquency status is reported separately from the fact that there is a modified payment plan. A delinquency is reported, in the "manner of payment" on the account. A "remarks code" is used to reflect the existence of a payment plan. The presence of a monthly payment plan remark code does not automatically mean that the account is delinquent.
2. N/A
3. In a proactive effort to avoid identity theft and ensure accuracy of items added to credit reports, perhaps a notification process should be established that would notify an individual when a credit rating agency is adding a new item to their report? How would you envision your entities implementing that notice? RESPONSE: Every day TransUnion updates tens of millions of credit reports by adding either new sources of information such as a new account, public record, collection item or inquiry or new information as to the account status of existing items on a consumer's credit report. We do provide, for a small fee, a service that allows consumers who are interested in learning of material updates to do so.