

reach more consumers – and allow more consumers to reach their goals

In the past, when a consumer's credit report did not contain sufficient data to generate a score, a lender was forced to either conduct a costly manual review or reject the applicant. First American's Anthem Score changes all of that forever.

FIRST AMERICAN'S NON-TRADITIONAL CREDIT SCORE

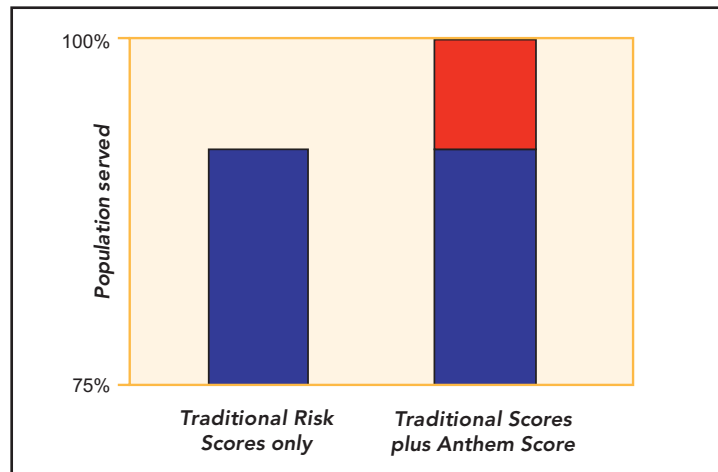
Anthem Score is the industry's first score generated from the same non-traditional credit data that comprises a non-traditional credit report. As such, it not only represents an accurate and reliable score for loan applicants that have previously been "un-scorable," it exceeds existing lender and investor standards.

Anthem Score is compiled using the most widely accepted non-traditional credit policy standards, including:

- Existing "thin" credit bureau data
- Current and previous rental histories
- Utility payments
- Non-deduction insurance payments
- Credit histories from businesses that do not report to any of the national repositories
- Regular child-care expenses

In compiling its numerical risk assessment, Anthem Score considers the type of credit, the length of credit, the payment history, and the verification methods used in confirming the credit. All of this comes together to produce a predictive score that measures the same risk as a traditional credit score.

EXPAND YOUR MARKET REACH WITH ANTHEM SCORE



NEW MARKETS, NEW OPPORTUNITIES

First American utilizes the industry's strictest standards to verify credit sources and applicant identity. This commitment to accuracy, consistency, and reliability allows you to confidently reach more consumers and allows more of your customers to reach their goals.

Anthem Score FEATURES

- ▶ First score compiled from the same credit data that comprises a non-traditional credit report
- ▶ Features an easy-to-use three-digit risk assessment score for previously "un-scorable" applicants that exceeds lender and investor standards
- ▶ Includes two factor codes detailing the credit tiers utilized and the verification method used for the rental history
- ▶ Comes at **no charge** with each First American non-traditional credit report

Anthem Score BENEFITS

- ▶ Expands market penetration in traditionally underserved sectors
- ▶ Protects originators and investors from fraud in higher risk markets
- ▶ Streamlines operations by reducing the time required to close loans
- ▶ Enables performance measurement of non-traditional loans

Fair Isaac and PRBC Team Up to Enhance Credit Risk Tools Used by Mortgage Industry

National Credit Reporting Association members to offer PRBC Credit Report with FICO Expansion Score

November 14, 2007 - (Minneapolis, Minnesota, USA and Annapolis, Maryland, USA) - Fair Isaac Corporation (NYSE:FIC), the leading provider of **analytics** and decision management technology, and Payment Reporting Builds Credit (PRBC), a credit information repository that collects, verifies and scores rental and bill payment data, today announced a new collaboration. They will deliver PRBC Credit Report with FICO® Expansion® Score, a comprehensive credit risk management tool that U.S. mortgage lenders can use when assessing the risk of applicants who have little or no traditional credit history.

PRBC Credit Report with FICO Expansion Score combines Fair Isaac's FICO Expansion Score with the underlying, comprehensive credit report which includes:

- Rental and bill payment data from PRBC's repository;
- Non-traditional credit history data from third-party sources;
- Traditional tri-merge credit bureau data when available.

FICO Expansion Score will incorporate all these data elements when calculating the credit risk of individuals who have minimal or no credit history on file. The FICO Expansion score uses non-traditional credit data to create a score that aligns with the FICO credit score used today by most mortgage lenders, using the same 300-850® score range.

"PRBC's alliance with Fair Isaac is an important step toward freeing mortgage lenders from the expensive and time-consuming, manual underwriting procedures they encounter when they try to lend to people who have little or no documented credit experience," said Michael Nathans, founder of PRBC. "By adding PRBC's verified rent and bill payment data to Fair Isaac's FICO Expansion Score and associated credit report, we are creating a new standard for assessing the credit risk of thin-file mortgage applicants."

"Adding PRBC's bill payment data to the FICO Expansion Score will make it an even more powerful predictor of credit risk for mortgage lenders," said Tom Quinn, vice president of Global Scoring for Fair Isaac. "Lenders will be able to easily access this new package through their existing connections to NCRA credit reporting agencies. In addition to helping lenders to eventually automate a manual underwriting process, this package also can help them to expand their markets, reduce losses, and make more financial services available to more people."

Consumer reporting agencies in the National Credit Reporting Association (NCRA) will sell the new risk-assessment package to mortgage lenders and brokers.

"NCRA is excited that our members have the opportunity to be part of this revolutionary mortgage credit risk assessment product," said Terry Clemans, NCRA's Executive Director. "The alliance between Fair Isaac and PRBC, combined with data from our membership that has been verified to higher standards than the industry has been accustomed to, will help lenders originate sustainable mortgage loans for an historically overlooked and underserved segment of home buyers."

The bill payment and rental histories tracked by PRBC are not found at the national credit reporting agencies, nor are the other non-traditional sources of consumer data tapped by the FICO Expansion Score. The PRBC Credit Report with FICO Expansion Score will provide lenders with their best tool

for assessing the credit risk of nearly 50 million adults who have little or no credit history on file, including recent immigrants and young adults. Businesses can use PRBC Credit Report with FICO Expansion Score to make more financial services available to more people who have missed out on opportunities simply because they lack a traditional credit history.

About PRBC

PRBC is a consumer reporting agency that collects, stores, scores, and reports bill payment data in compliance with the Fair Credit Reporting Act. It is the first credit repository to give prospective borrowers the tools to demonstrate their creditworthiness without the need to go into debt. PRBC receives payment data from financial institutions' bill payment services when consumers choose to have their payments reported. In addition, PRBC has partnered with the National Credit Reporting Association to use industry best practices to verify trade line accounts and up to three years worth of prior payments that consumers can report directly to PRBC.

PRBC Reports meet Fannie Mae's, Freddie Mac's, and FHA's standards for documenting creditworthiness in the absence of a traditional credit history. PRBC does not charge consumers a fee to enroll in the service or to view their own payment data. Consumers and businesses can learn more about PRBC at www.prbc.com.

About NCRA

The National Credit Reporting Association, Inc. (NCRA) is a non-profit trade association founded in 1992 that represents the Consumer Reporting Industry and specifically Mortgage Credit Reporting Agencies. NCRA represents more than 95 of the 120 Credit Reporting Agencies in the United States and Puerto Rico that produce the specialized Mortgage Credit Reports as required by the Department of Housing and Urban Development, (HUD) Fannie Mae and Freddie Mac for mortgage loan underwriting. NCRA members provide the mortgage lending community in excess of 3,000,000 mortgage credit reports per month.

About Fair Isaac

Fair Isaac Corporation (NYSE:FIC) combines trusted advice, world-class **analytics** and innovative applications to help businesses make smarter decisions. Fair Isaac's solutions and technologies for Enterprise Decision Management turn strategy into action and elevate business performance by giving organizations the power to automate more decisions, improve the quality of their decisions, and connect decisions across their business. Clients in 80 countries work with Fair Isaac to increase customer loyalty and profitability, cut fraud losses, manage credit risk, meet regulatory and competitive demands, and rapidly build market share. Information about FICO® Expansion® Score is available through Fair Isaac's business and consumer portal website at www.myFICO.com/Business.

Fair Isaac Statement Concerning Forward-Looking Information

Except for historical information contained herein, the statements contained in this press release that relate to Fair Isaac, including statements regarding its FICO® Expansion® Score and the benefits to be derived from this offering, and the relationship described herein, are forward-looking statements within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially, including any unforeseen technical difficulties related to the implementation, use and functionality of the offering, the risks that customers will not perceive material benefits from the offering, failure of the product to deliver the expected results, the possibility of errors or defects in the offering, regulatory changes applicable to the use of consumer credit and other data, and other risks described from time to time in Fair Isaac's SEC reports, including its Annual Report for the year ended September 30, 2006, and quarterly report on Form 10-Q for the period ended June 30, 2007. Forward-looking statements should be considered with caution. If any of these risks or uncertainties materializes or any of these assumptions proves incorrect, Fair Isaac's results could differ materially from Fair Isaac's expectations in these statements. Fair Isaac disclaims any intent or obligation to update these forward-looking statements.

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Reaching Deeper: Using Alternative Data Sources to Increase the Efficacy of Credit Scoring

Introduction

With consumer debt levels at an all-time high and the credit card and mortgage markets heavily saturated, the financial services industry has begun to turn its attention to the vast untapped pool of consumers who have minimal credit histories but aren't necessarily poor credit risks. While estimates vary, as many as 70 million Americans are believed to have "thin files," or no credit files at all, making it difficult to use traditional credit scoring to underwrite them. These consumers tend to be grouped in minority, poor and other low income populations; the elderly, recent widows and new immigrants are also important segments within this "thin file" group of underbanked consumers.¹

This issue is a challenge for both financial institutions and for thin-file customers themselves. Without adequate access to credit, the underbanked are hampered from purchasing products such as personal or auto loans, mortgages and other asset-building vehicles. Credit scores play an increasingly significant role in consumers' financial lives and can have a critical impact on their economic security. Lacking a formal credit history can affect consumers' ability to get competitive mortgage and non-mortgage credit. In addition, credit scores are used increasingly for other purposes, such as determining auto and home insurance rates, hiring employees, and approving rental applicants. The negative consequences of an absent credit history can mean loss of access to a new job, apartment, or low-cost insurance. And ultimately, not having a credit history seriously impairs consumers' ability to access the most popular road to asset-building in America today—homeownership. In 2004, for the whole of the American population, home equity accounted for 42% of all assets of those who owned their homes. However, this share increases as household income decreases, with home equity representing 80% of all assets for the lowest income quintile.²

With an eye on new markets, innovation in the financial services industry has led to the creation of products, delivery channels and providers that fall outside the traditional credit reporting system, including prepaid debit cards, remittances, and electronic bill payment solutions. A variety of industry players are beginning to collect and experiment with this and other alternative data sources to understand their predictive value and how to integrate them into automated underwriting models. This work is in its infancy and results are not yet clear or even available in many cases. Even so, a significant number of innovative pilots and studies are providing the needed momentum to catapult this issue to the top of the financial service industry's agenda. This report describes the current credit reporting system, why it doesn't work for everyone, and efforts underway to improve it with the addition of new data sources.

¹ Information Policy Institute, "Giving Underserved Consumers Better Access to the Credit System: The Promise of Non-Traditional Data," July 2005, p. 7.

² Ibid, p. 4.

How the Current Credit Reporting System Works

While third-party credit data collection has been part of American business since the mid-1800s, it wasn't until the 1950s that financial service companies were able to leverage its benefits. That's when two mathematicians—Fair and Isaac—developed models to predict risk, uncovering which factors were actually reliable predictors of a consumer's performance after the credit was approved. The result of their work is the familiar FICO® scores. Under the Equal Credit Opportunity Act (ECOA), a credit scoring system may not use certain characteristics - like race, sex, marital status, national origin, or religion - as factors. Creditors are allowed to use age in properly designed scoring systems, but any such scoring system must give equal treatment to elderly applicants. Because credit scoring is based on real data and statistics, it is perceived to be more reliable than subjective or judgmental methods. Currently, financial service companies can make automated decisions on credit approvals. Credit scores advanced the salability of loans to the secondary market, and accelerated monetary transactions with fewer losses.

While credit score modeling transformed the market, it is the day-to-day collection of data that remains the foundation of the system. Third-party companies, or credit bureaus, routinely collect individual consumer information that includes information on loan payment history, the number, age and type of accounts, late payments, collection actions, and outstanding debt. The data is then processed through a statistical program that compares this information to the credit performance of consumers with similar profiles. A credit scoring system awards points for each factor that helps predict who is most likely to repay a debt. A total number of points — a credit score — helps predict how creditworthy an individual is, that is, how likely it is that they will repay a loan and make the payments when due.

Today, there are three major credit bureaus - TransUnion, Experian, and Equifax. Together they collect data on more than 200 million U.S. residents. There are also smaller local credit reporting agencies that focus on regional markets. Most credit grantors report to one or more of the major credit bureaus. In general, the credit reporting agencies don't pass information amongst themselves, so most consumers have at least three separate credit records.

Decision-making Factors and Repercussions

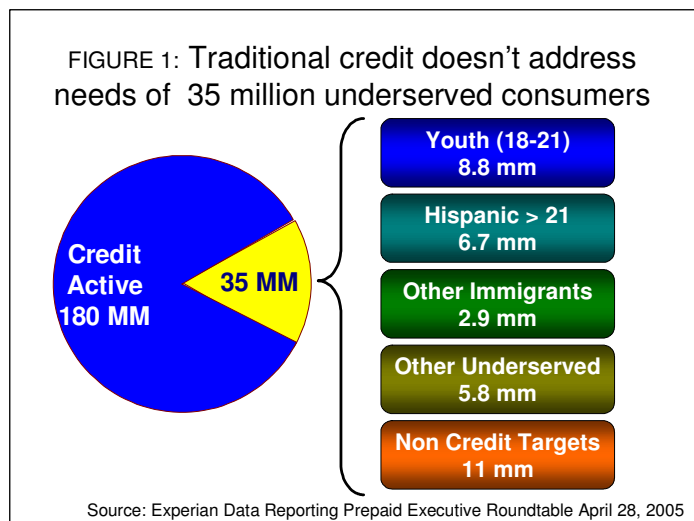
Another way that financial services companies make decisions about offering credit to consumers is the extensive use of ChexSystems to enable consumers to open bank accounts. ChexSystems, a subsidiary of eFunds Inc., is the largest specialized collector of information on consumers' checking account activity. Founded in 1971, 80% of U.S. banks, including all of the major banks, employ ChexSystems to deter fraud and evaluate risk in opening checking accounts.³ Some banks have also employed ChexSystems as part of their approval process for loans, credit applications, and opening savings accounts. ChexSystems incorporates

³ James Marvin Perez, "Blacklisted: The Unwarranted Divestment of Access to Bank Accounts," New York University Law Review, 2005.

information on past bank account activity to help banks mitigate risk. Participating banks report information on forced closures, non-sufficient funds activity, bounced checks and similar items. This information is linked to a consumer's name in the ChexSystems database, and depending on the risk model developed by the financial institution, can trigger denial or approval of bank accounts and other financial services.

In 1999, the company introduced a new product, QualiFile, to integrate other kinds of indicators, such as check printing history, retail scans of checks, and credit report data, in order to make decisions about offering specific services to customers. The premise behind QualiFile is that credit is not the only factor in determining acceptable risk; debit and credit information together provide a more detailed consumer picture expanding opportunities to open accounts and offer more products.⁴ But the product is only as good as the data available for inclusion in the model.

Despite all of the information that is being collected by credit bureaus and factored into credit scoring models, millions of consumers are effectively left out of the system, though estimates vary. On the high end, the National Credit Reporting Association (NCRA) estimates that more than 70 million Americans have either no credit score, or a lower credit score than their financial history and payment potential warrants.⁵ On the low end, Experian estimates that traditional credit reporting methods do not address the needs of 35 million consumers, including 8.8 million youth, 6.7 million Hispanic consumers, and 2.9 million non-Hispanic immigrants (see figure 1).



Finally, Fair Isaac estimates that 20% of Americans lack credit files that can be scored.⁶ That translates to 54 million people: 22 million with no credit history, and an additional 32 million with relatively short or little history, or thin files. By serving just 3% of this market, Fair Isaac estimates that lenders could generate \$2.3 billion in the mortgage market, \$750 million in the auto market, and \$113 million in the credit card market.⁷

⁴ <http://www.riskworld.com/PressRel/1999/PR99a104.htm>

⁵ U.S. Newswire "The National Credit Reporting Association and PRBC Join Forces to Help Consumers Build Alternative Credit Histories," October 3, 2005.

⁶ FICO® Scores and the Credit Underserved Market, Janice Horan, December 30, 2005. http://www.brookings.edu/metro/umi/20051215_Jhoran_FairIsaac.pdf

A Changing Industry

While consumers make regular payments for a variety of goods and services, such as rent, child care, health care, and automobile liability insurance, lenders and credit bureaus have been reluctant to incorporate this data into their systems. These types of “non-traditional” credit scoring data are gaining exposure and interest in the industry. However, they have not been incorporated into credit scoring models to date because of both the difficulty of data collection and the uncertainty of whether the data is predictive of a consumer’s probability of future payment. For example, a growing number of consumers are using prepaid cards as an alternative to checking accounts to make payments to a wide variety of merchants and service providers, but even this product with high-tech underpinnings has not been embraced by the credit industry because of uncertainty of the predictive nature of the data.⁸ Likewise, the secondary market has been cautious about these new forms of scoring and currently does not purchase loans using alternative scores. Finally, legislative and regulatory prohibitions enacted to protect consumers’ identities, particularly state regulations related to disclosure of utility payments, can also inhibit the reporting of alternative sources.

Today’s competitive financial services climate has the credit reporting industry changing the way it views its role and the opportunities that it can provide its clients to attain new customers. What are the options for consumers who fall out of traditional credit reporting profiles? By defining “credit-like” as a service or good that is provided in advance of the receipt of payment, there is an opportunity to expand the universe of credit-worthy consumers. The majority of those with unscorable thin-files or without files at all do engage in activities that can be thought of as “credit-like.”⁹ While these transactions are not traditional credit agreements, they mirror the essential elements of traditional credit agreements in that they are recurring relationships that entail regular payments. In fact, the vast majority of people in the thin-file segment of the population do demonstrate a sense of responsibility through various agreements to pay for regular service – for example, rent, utilities, and auto insurance. Even basic checking account data on balances and deposits, which looks nothing like credit, may have some value in predicting repayment behavior for smaller, shorter-term credit products like lines of credit.

A Work in Progress: How the Traditional Credit Bureau and Reporting System is Responding to a Changing Marketplace

The traditional credit scoring industry has begun to experiment with different strategies to accept non-traditional data and incorporate it into consumers’ credit scores. For example, Fair Isaac Corporation developed the FICO Expansion score for credit applicants with little-to-no traditional credit histories. The FICO Expansion score uses non-traditional data including utility payments, insurance payments and others to assess the risk of consumers who lack sufficient data in their credit files to generate a classic FICO score. Fair Isaac estimates that an Expansion score can

7 Ibid

8 Ibid

9 Information Policy Institute, 2005.

be generated for more than 60% of applicants that are “thin file” or “no hit” based on traditional credit data.¹⁰

In addition, one of the three major credit bureaus, Experian, is moving forward with the development of an alternative data solution through a pilot program with Los Angeles-area companies by actively acquiring alternative data on underserved consumers in the market.¹¹ The objective is to acquire enough information from a wide variety of sources to be able to establish a complete profile of the underserved consumer. The pilot will incorporate checking account history, payday loans, property rental history, rent-to-own transactions and other kinds of data. Once enough data has been collected, selected lenders will begin testing its predictive value.

First American Corporation, a credit reporting agency, is another company that sees opportunities in expanding the credit reporting system. The Anthem (Assisting Nontraditional Homebuyers in Emerging Markets) Report is specifically designed to address mortgage lender and investor needs of a reliable way to assess the credit risk of loan applicants with little or no traditional credit history. The Anthem Score takes into consideration both positive information and negative factors such as rent, insurance, utility bills and child care expenses – along with any traditional credit information that is available – to generate a credit score that can be used by lenders to rate a person’s creditworthiness. This helps mortgage lenders address many of the credit challenges these potential homebuyers face, while sufficiently managing the risk to the lender and the secondary market/investment community.

In generating an Anthem Score, the consumer is asked to provide information such as canceled checks or receipts for rent, utility and phone bills, insurance premiums and other appropriate expenses. First American verifies the data, generates the report and accompanying score, and sends it to the lender. Anthem Scores range from 300 and 850, and take into consideration the type of non-traditional data used to generate the score, and how it was verified.

Alternative Providers Stress Innovation in Data Collection

A variety of alternative providers are developing options that will make the credit reporting system more inclusive. Meanwhile, financial institutions, seeing a large, untapped market of potentially lucrative customers, are beginning to accept non-traditional forms of data to make credit decisions for mortgages and other lines of credit.

For many underbanked consumers with limited access to credit, the only option for immediate short-term credit is to apply for a payday loan. Despite high interest rates and fees, many consumers do repay their loans on time, but do not receive the advantage of building a formal credit history. In 2005, the Community Financial Services Association of America (CFSA) and

¹⁰ <http://www.fairisaac.com/NR/exeres/3277CC55-8F48-4F18-919B-3E363B1B4EF8,frameless.htm>

¹¹ Jennifer Tescher, “Expanded Credit Data Will Help Banks, Poor,” *American Banker*, February 24, 2006, Vol. 171, Iss. 37, Pg. 8.

PRBC (formerly Pay Rent Build Credit) began a pilot program to help short-term borrowers build credit by voluntarily reporting their loan repayments. Currently, traditional credit reporting agencies do not track or score payday loan payments, and payday lenders tend to report only poor payment history to Teletrack, an alternative credit bureau. As a result, payday loan users have difficulty graduating to more mainstream and less expensive credit.

CFSA, the largest association of payday loan companies representing more than half of the payday advance locations nationwide, determined that payday advance companies could provide their customers an additional service by reporting repayment data to credit bureaus. The focus of PRBC's business model is to develop systems and relationships to obtain large amounts of bill payment information, primarily from previously untapped sources. CFSA and PRBC collaborated to enable payday advance customers to use their payment histories to gain access to more traditional financial services and asset-building opportunities.¹²

The pilot was rolled out during the summer of 2005 through CFSA member companies Advance America, Check into Cash and Valued Services, at locations in Chicago, Texas and North Carolina. Specially-developed marketing and educational materials in English and Spanish were provided to all loan applicants at these locations. The brochures explained the concepts of credit histories and scoring as well as the advantages of opting-in to have repayment information reported to PRBC. Approximately 80% of applicants agreed to participate. The data has been added to the PRBC database that is used to produce a Bill Payment Score. The score can be used to supplement a traditional credit score, or be used in the absence of one, to gain a more complete and accurate risk assessment of an applicant.

CFSA members' use of the PRBC service helps their customers to demonstrate the ability and willingness to pay their financial obligations as agreed, and it helps both financial institutions and other service providers to more accurately and fairly assess their creditworthiness. Advance America is continuing its participation in the project, and all CFSA members are now eligible to use the PRBC service. As the effort grows, it will be important to revisit existing credit scoring models to ensure that they don't downgrade consumers who use payday loans, regardless of their payment history.

Expanding the role of CDFIs and Micro-lenders

Community Development Financial Institutions (CDFIs) and micro-lenders also are demonstrating an increasing interest in credit reporting for their customers. While some of these organizations report payment history data on their borrowers to national credit bureaus, many do not have the resources to do so, while others do not have a large enough volume of loans to report. While the clients of these organizations benefit with access to credit that they may not have accessed otherwise, community lending programs see the benefit of providing their borrowers with an opportunity to develop positive credit histories with higher scores that will position them to access mainstream financing over time.

¹² http://www.payrentbuildcredit.com/pub/PRBC_CFSA_Press_Release_050606.pdf



While a variety of issues prevent microfinance and housing loan funds from participating in the national system of credit reporting, two critical barriers stand out – cost and minimum account requirements instituted by the three big credit reporting agencies. In recent years, Experian, TransUnion, and Equifax have required minimum account volumes, sometimes as high as 500 accounts or more. Only a handful of nonprofit lenders have sizable enough portfolios to meet this threshold.

To address the significant issues related to data collection, report batching and reporting cost, the Central Vermont Community Action Council, a 40-year-old community development corporation, has recently launched Credit Builders of America (CBA). With the support of the Association for Enterprise Opportunity (AEO), a trade group representing U.S. microenterprise organizations, CBA will serve as an intermediary to assist CDFIs and other nonprofit lenders to report borrower credit history by collecting data in the required format and creating scale to meet volume thresholds.¹³ CBA's vision is to become a one-stop shop where members can also pull credit reports for their potential and current borrowers, as well as report repayment. The ultimate goal is to assist borrowers in establishing credit relationships with conventional financial institutions. In addition, CBA hopes to provide an affinity card for member borrowers to access small lines of credit.

¹³ The creation and development of CBA was funded in part by a grant from the Center for Financial Services Innovation in 2005.



Conclusion

Extensive innovation is occurring in the collection, analysis and use of alternative data sources to reach untapped credit markets. If successful, these efforts can help bring millions of underbanked consumers into the credit mainstream, enabling them to both improve the terms of existing credit obligations and access new products and services. It is unclear at present how the industry will deal with the predictive nature of non-traditional data and how many consumers will gain access to positive credit through these new channels, but the innovations and experiments described here offer promising opportunities to move in that direction.

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An Affiliate of ShoreBank Corporation

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The Center for Financial Services Innovation (CFSI) assists the financial services industry to identify, develop, and implement innovative ways of delivering asset-building opportunities to the underbanked market that are profitable for both company and customer.

CFSI, an affiliate of ShoreBank Corporation with support from the Ford Foundation, was founded in 2004 to encourage the financial services industry's efforts to serve un- and underbanked consumers. The Center provides funding for innovative solutions, a meeting place for interested parties, resources for testing products and services, and identifies, develops and distributes authoritative information on how to respond to the needs of the underbanked profitably and responsibly. Banks, credit unions, technology vendors, alternative service providers, consumer advocates, and policy makers all can find support here to forge the new relationships, products, and strategies that will transform industry practice and people's lives. For more on CFSI, visit www.cfsinnovation.com.

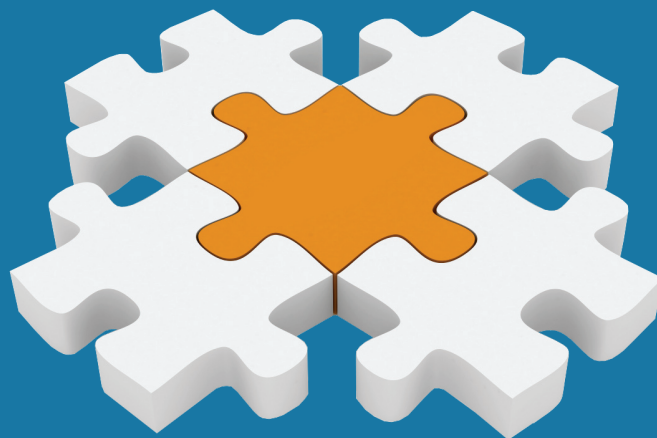
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New to Credit from Alternative Data



By: Michael A. Turner, Ph.D., Patrick Walker, M.A. and Katrina Dusek, M.A.

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New to Credit from Alternative Data

By: Michael A. Turner, Ph.D., Patrick Walker, M.A. and Katrina Dusek, M.A.

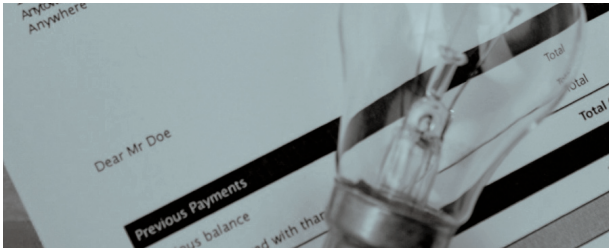
March 2009

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Abstract

This report highlights the findings of two previous PERC studies, *Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit Using Alternative Data* and *You Score, You Win: the Consequences of Giving Credit Where Credit is Due*. This report specifically focuses on the new to credit consumer population and how their ability to obtain credit is increased through the reporting of alternative data. Substantial research supports the premise that alternative data tradelines help to incorporate a class of credit underserved consumers into mainstream finance by providing enough data to achieve a credit score. New PERC research shows that using alternative data in underwriting does not negatively affect consumer credit scores over time, and does not lead to above average levels of over-extension in the new-to-credit population. Additionally, PERC research shows that the inclusion of alternative data in credit files is most likely to help minority and low-income consumers achieve credit scores and obtain access to affordable mainstream credit, a key step in the asset building process.



I. The Benefits of Alternative Data

A. America's Credit Invisibles

An estimated 35-54 million Americans are currently outside the credit mainstream due to having a thin credit file or no credit file at all.¹ These credit underserved are disproportionately young adults who have yet to establish a credit history, immigrants with little credit history from their home countries, the elderly, including divorcees or widows who previously enjoyed access to credit through their spouse but have not established their individual credit history, ethnic minorities, low income earners and those who simply distrust the credit system². These consumers are disadvantaged in accessing re-

sponsible, affordable credit due to insufficient payment information available to assess their credit risk. Given insufficient data, the default assumption of lenders in that no score equals high risk. Such applicants are almost always rejected.

Many such people are low-risk, active consumers that regularly pay rent, utility, and mobile phone bills. However, non-financial payment information is rarely reported to the consumer credit bureaus. When it is reported, it is overwhelmingly just the late payment, default, or collections information.

The credit system in the United States has evolved so that loans are priced according to a borrower's individual risk (risk-based pricing) and to a borrower's credit capacity. This credit system relies on credit bureau data to assess credit worthiness. Consequently, a credit "Catch-22" exists in America: one must have credit to get credit. This is particularly true following the credit crisis. Individuals must first show that they are low risk before they can access mainstream credit at reasonable prices (fees and interest rates).

¹ Turner et al. (2006) *Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit Using Alternative Data* Political and Economic Research Council and The Brookings Institution Urban Markets Initiative, 2.

² Maas, Ericca. (2008) "Credit scoring and the credit-underserved population" The Federal Reserve Bank of Minneapolis. (16 Sep 2008) Available: http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=2452 .

The inability to access affordable mainstream credit is a major problem for many Americans. Consumers without a credit history are unknown entities. The lack of information about these consumers leads them to be classified as an unacceptable risk to financial institutions, just as consumers who have demonstrated irresponsible financial habits are unacceptable risks. The untested consumers are themselves forced to assume risk through irresponsible and expensive forms of credit. Without access to mainstream credit these consumers fall into a class which must look to check cashing services, payday loans (with effective interest rates up to 500%³), and predatory lenders to gain access to credit. These forms of credit are not only risky to the consumer, but expensive due to excessive interest rates and fees that those within the mainstream credit system do not experience. The Brookings Institution's Metropolitan Policy Program reports that more than 4 million low-income consumers pay higher auto loan and mortgage interest rates, showing that there is a monetary cost associated with having a low income and no credit file information⁴. These additional costs could be alleviated through reinforcing the information in credit files with alternative data.

³ Op Cit. (Turner)

⁴ Fellows, Matt. "High Cost of Being Poor: Reducing the Costs of Living for Working Class Families" The Brookings Institution, October 2006.

⁵ National Cable and Telecommunications Association, Industry Overview. www.ncta.com/Docs/PageContent.cfm?pageID=304. Source: Nielsen Media Research. As cited in: Turner, Michael. Giving Underserved Consumers Better Access to the Credit System: The Promise of Non-traditional Data Information Policy Institute, July 2006.

⁶ Alternative data is derived from all payment history data in the non-traditional credit sector.

⁷ New-to-credit consumers are predominantly thin-file or have no trades on file. These consumers have low credit scores or are unscorable due to the lack of information in their file.

B. Redefining Credit

In order to include the 35-54 million Americans who aren't able to access affordable credit, the definition of credit must not be confined to traditional forms. In fact, many Americans who find themselves excluded from mainstream credit are active participants in non-traditional credit systems, such as utility and telecom services. Nearly all households in the US have electricity and a telephone, and a majority have cable television⁵. Such services are extended to consumers prior to their payment, and therefore are essentially extended by a utility or telecom company in the form of credit.

This system of credit extends a service with the expectation of repayment, similar to how a traditional credit institution extends assets with the same expectation. The difference is that **in this non-traditional credit system, consumers are not typically rewarded for their timely repayments, but are commonly penalized for late payments.**

By reporting alternative data⁶ to credit bureaus, utility and telecom companies can allow new to credit⁷ consumers to build a credit history without

the necessity of borrowing, thereby overcoming the “credit Catch-22”. With a credit history, the door will be opened for millions of credit underserved Americans to responsible and affordable traditional credit.

How quickly can this happen? Almost instantly. That is because there is a clear harmony of interests on this issue among all stakeholders—lenders, data furnishers, borrowers, and the government. Some major banks are already underwriting loans using alternative data when available. Given the current credit crunch, accessing new data to improve their ability to accurately assess risk and extend new loans is a business imperative. As many credit scoring models only need one payment history to produce a credit score, alternative data has the potential to virtually eliminate no-file consumers⁸.

Utility and telecom services that report payment information also benefit, because customers are more likely to pay when they know that their credit file is impacted by their financial habits. A recent PERC study, *Fully Reporting Non-Financial Payment Data: Impact on Customer Payment Behavior and Furnisher Costs and Benefits*, includes a consumer payment behavior survey and finds that approximately 50% of consumers are “much more likely” or “somewhat more likely” to prioritize the payment of utility and/or telecom bills if they knew the information was reported to credit bureaus⁹.

Borrowers in need of credit now will have more and better choices. Paying less for credit, and having access to greater amounts should enable asset building and wealth creation. And from the perspective of a government coping with a financial crisis and spreading recession, [enabling the reporting of alternative data to credit bureaus is one tool that can be used to increase credit access and stimulate growth – and it won't cost taxpayers a penny.](#)

⁸ Turner, Michael and Amita Agarwal. “Using non-traditional data for underwriting loans to thin-file borrowers: Evidence, tips, and precautions”. *Journal of Risk Management in Financial Institutions*. 1:2, pp.165-180. Available: <http://www.infopolicy.org/files/downloads/pp165-80.pdf>.

⁹ Turner et al., (2008) *Fully Reporting Non-Financial Payment Data: Impact on Customer Payment Behavior and Furnisher Costs and Benefits* PERC. For additional resources see Afshar, Anna (2005) *Uses of Alternative Credit Data Offers Promise, Raises Issues* New England Community Developments Issue 1, Third Quarter 2005.



II. Assessing risk using non-traditional data in new to credit consumer files

Can a positive history of repayment in the non-traditional credit sector predict payment habits for traditional credit? That is, can alternative data be used in credit scoring models to accurately assess credit risk? Further, what are the impacts on credit access? And how much promise does this hold for new to credit borrowers? These are empirical questions that can only be answered with empirical evidence.

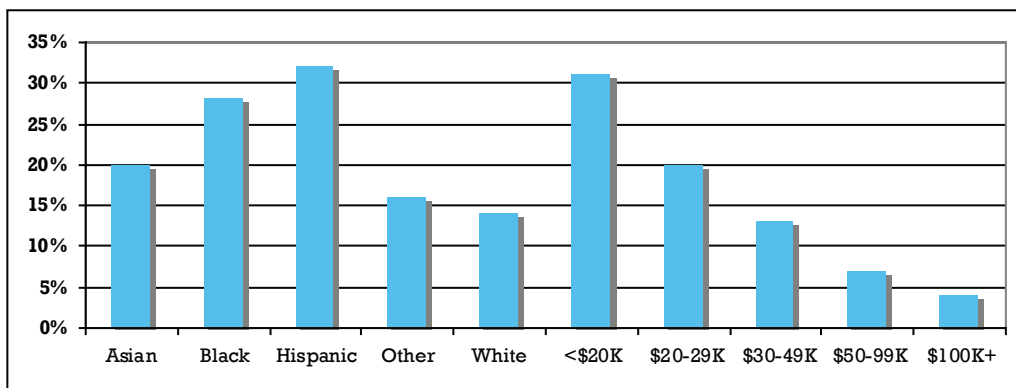
In 2006, PERC and the Brookings Institution released *Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit Using Alternative Data*. This study of eight million credit files from TransUnion, a leader in collecting such data, focused on thin-file consumers and, in particular, thin-file consumers that were deemed “unscoreable” due to the lack of trade information in their credit files. Many of these thin-file consumers could likely be deemed new to credit, or soon to be new to credit. The analysis and findings from this research provide a first-time look into the changes in borrowers’ credit profiles as a result of the inclusion of alternative data in consumer credit files. That is, does having a non-traditional tradeline result in credit access? And do the new borrowers become over-extended as a result of easy credit?

In the first such analysis of its kind, PERC’s 2006 socio-demographic examination shows which segments of the population are most likely to have thin credit files. This data shows that ethnic minorities, lower-income consumers, the young and the old are more likely to be thin-file borrowers¹⁰.

¹⁰ Turner et al., (2006) *Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit Using Alternative Data* PERC and the Brookings Institution Urban Market Initiative. The Center for Financial Services Innovation’s (CFSI) recent analysis of the demographic makeup of the underbanked are consistent with PERC’s earlier findings for the makeup of the thin-file population, see http://www.cfsinnovation.com/doc.php?load=/underbankedconsumerstudy_factsheet_june82008_final1cw.pdf.

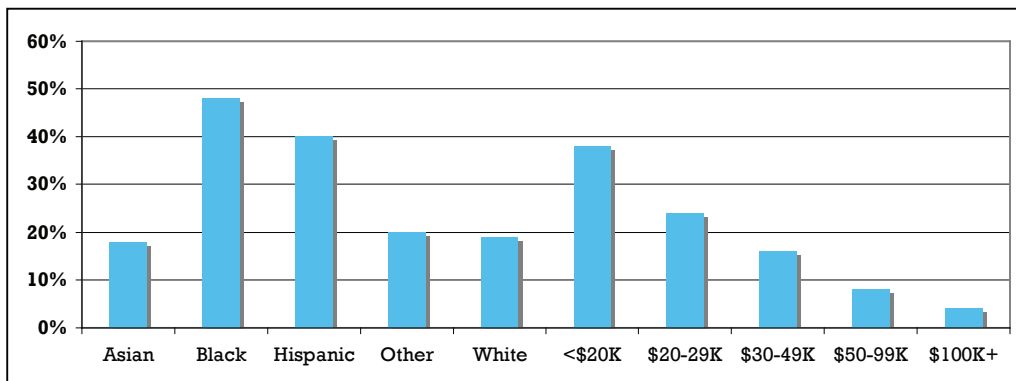
Figures 1 and 2 below show the percentage of socio-demographic groups (ethnicity and income groups) in the Give Credit Where Credit is Due analysis that are thin-file (fewer than three traditional tradelines).

FIGURE 1: Thin-file Rate by Socio-demographic Group (Utility tradelines sample)



Source: Turner et al., (2006) *Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit Using Alternative Data* PERC and the Brookings Institution Urban Market Initiative.

FIGURE 2: Thin-file Rate by Socio-demographic Group (Telecom tradelines sample)

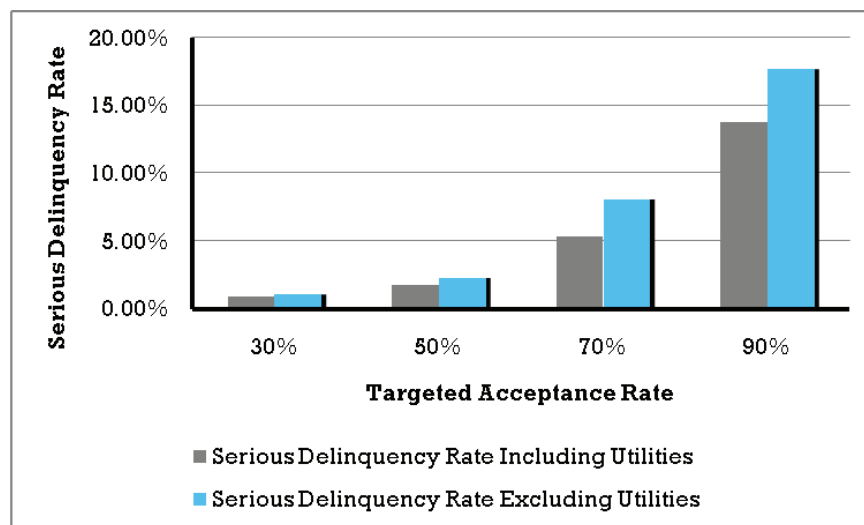


Source: Turner et al., (2006) *Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit Using Alternative Data* PERC and the Brookings Institution Urban Market Initiative.

Many concerns have been raised over how a population that had traditionally been unable to access affordable credit would react to new credit opportunities. PERC's research should be utilized as a baseline study, an initial glimpse into what one should expect for those taking advantage of non-traditional tradelines and becoming new to credit consumers. Most basically, *Give Credit Where Credit is Due* examines whether alternative data is useful in risk assessment. The trade-off between delinquency rates and acceptance rates is one way the usefulness of data can be evaluated.

The figures below show the change in number of delinquencies experienced among groups of consumers selected when alternative data is included in determining credit-worthiness and when it is not. PERC's research finds that for each targeted acceptance rate (size of the group selected), serious payment delinquencies¹¹ fell when the alternative data was included with traditional data and used to assess credit risk. This provides general evidence that alternative payment data can improve the ability of scoring models to predict who will and will not have serious delinquencies. In turn, this enables banks to broaden credit access without taking on undue risk. Credit is made fairer and smarter simultaneously.

FIGURE 3: Serious Delinquency Rates by Targeted Acceptance Rates Using Credit Scores With and Without Utility Data (VantageScore Model)



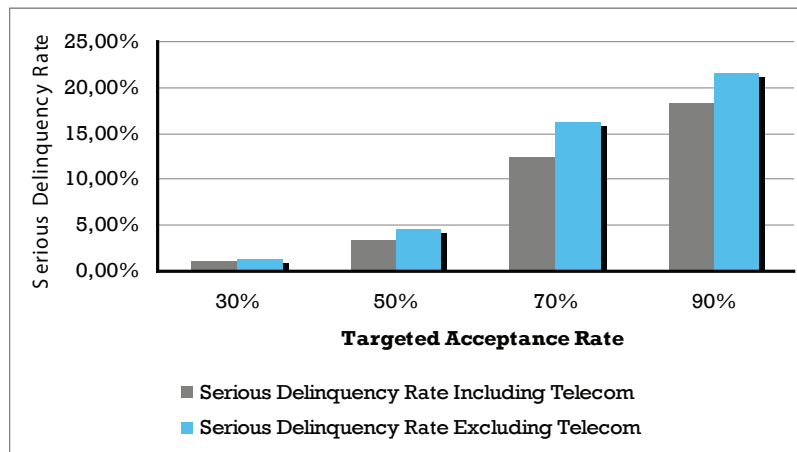
Source: Turner et al. (2006) *Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit Using Alternative Data* Political and Economic Research Council and The Brookings Institution Urban Markets Initiative

¹¹Delinquency is defined as a payment that is 90 days or more overdue.

The ability of credit grantors to better predict credit-worthiness provides security for the credit industry because it guards against adverse selection¹². As the rates of delinquency decrease, the costs associated with bad loans are lessened. This means banks will have lower provisioning/capital adequacy requirements, which translates into more money to lend. That is, alternative data not only makes lending fairer and smarter, but also more profitable to lenders. Good news in today's economy.



FIGURE 4: Delinquency Rates by Targeted Acceptance Rates Using Telecommunications Alternative Data (VantageScore Model)



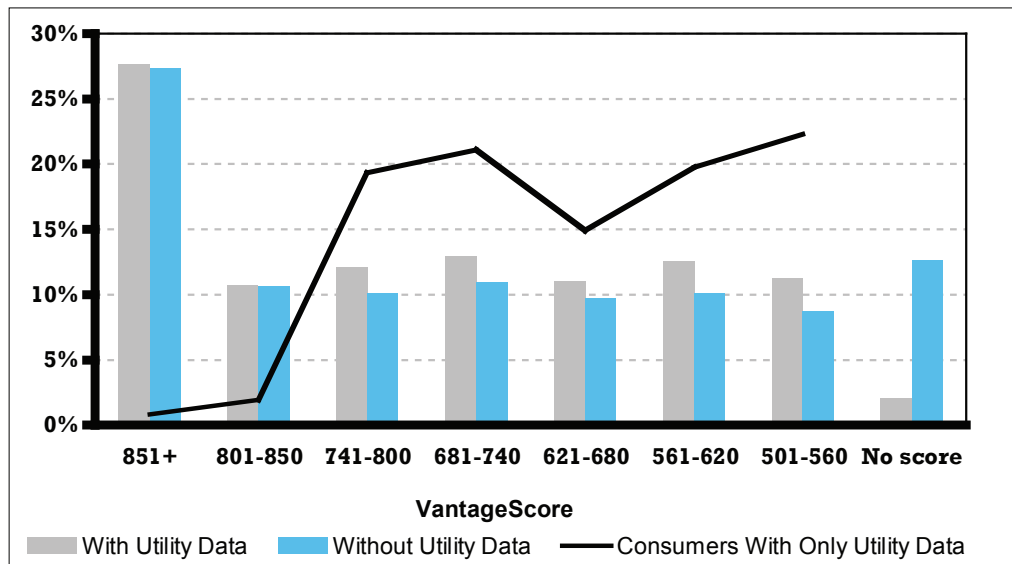
Source: Turner et al. (2006) *Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit Using Alternative Data* Political and Economic Research Council and The Brookings Institution Urban Markets Initiative

¹²Adverse selection occurs when lenders have limited information upon which to base their loan decisions and select customers who are unable to meet credit obligations. See Hunt, Robert M. (June 2005) A Century of Consumer Credit Reporting in America Federal Reserve Bank of Philadelphia Working Paper 05-13; www.philadelphiafed.org/files/wps/2005/wp05-13.pdf

Findings from *Give Credit Where Credit is Due* shows evidence of the extent to which new to credit consumers can benefit from the reporting of alternative data¹³. Specifically, thin-file consumers with utility or telecom payment histories witnessed greater increases in credit limits over a yearlong observation period relative to thin-file consumers with no such additional payment

information. On average, the limits increased by \$2,500 for those consumers with utility data and by \$1,100 for those with telecom data compared to a decline of \$382 for thin-file consumers without additional alternative data. It is likely that the “thickening” of credit files with non-financial payment data enabled this improved credit access¹⁴.

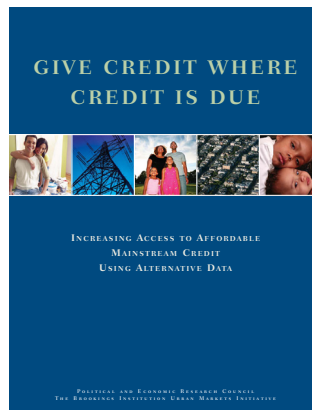
FIGURE 5: Distribution of Credit Scores for All Consumers in Sample With and Without Utility Payment Data and for those Consumers with Only Utility Payment Data



Source: Turner, Michael and Amita Agarwal. “Using non-traditional data for underwriting loans to thin-file borrowers: Evidence, tips, and precautions.” *Journal of Risk Management in Financial Institutions*. 1:2, pp 171. Available: <http://www.infopolicy.org/files/downloads/pp165-80.pdf>.

¹³ Turner et al. (2006) *Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit Using Alternative Data* Political and Economic Research Council and The Brookings Institution Urban Markets Initiative, 23.

¹⁴ Op. cit., 21.



<http://www.infopolicy.org/pdf/alt-data.pdf>

Perhaps the most substantial contribution of *Give Credit Where Credit is Due* is its preliminary assessment of the risk associated with extending traditional credit to this class of consumers. One of the key findings of this study shows that when alternative data is considered in determining risk, the credit risk profiles of mainstream consumers is similar to that thin-file and no-file consumers, but for super-prime¹⁵.

As Figure 5 shows, when alternative data is included in credit files, and used in credit scoring, the share that is unscorable falls from about 12 percent to 2 percent and the share with scores between 501 and 800 rises from about 50 percent

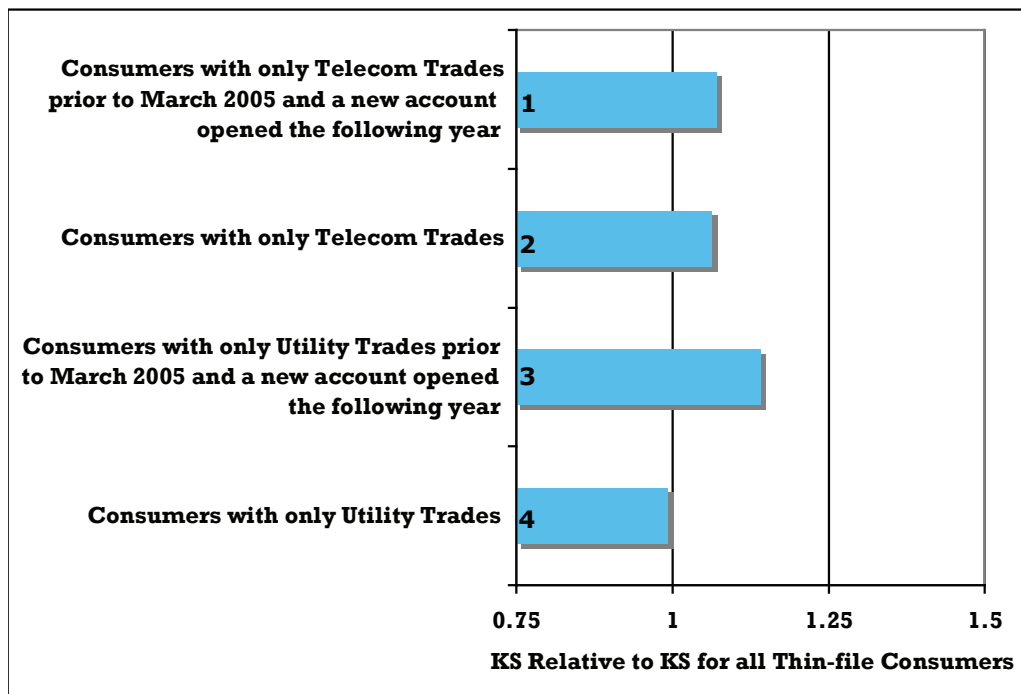
to 60 percent. As the black line shows, many of the 10 percent of the sample that becomes scoreable with the utility data, because they only have utility data, gain scores that put them in the middle of the score distribution. That is, a sizeable share is shown not to be high risk and gain access to mainstream credit from their utility payment information. In fact, another key result of *Give Credit Where Credit is Due* is that if a target default rate of 3% is chosen, a lender could extend credit to an additional 10 percent of the sample if utility and telecom payment data were included in generating credit scores.

¹⁵ Op. cit.

Figure 6 displays results comparing model performance (KS statistic) when different data are used to predict and outcomes are predicted over different data. (1) and (2) are KS statistics relative all thin-file consumers in the sample with at least one telecom account reported. (3) and (4) are KS statistics relative all thin-file consumers in the sample with at least one utility account reported.

So, comparisons are made to payment predictions among consumers with fewer than three traditional accounts and at least one alternative account. Model performance when predicting payment outcomes amongst thin-file consumers appears similar to the performance when using alternative account histories to predict alternative account payment outcomes or alternative *and* new account payment outcomes.

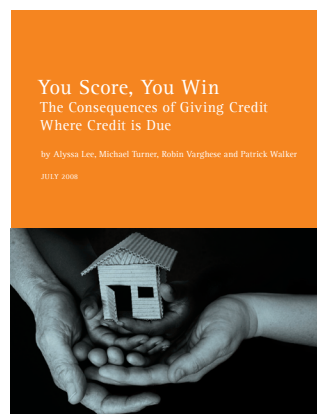
FIGURE 6: Predictability of Serious Delinquencies Using Alternative Data (VantageScore Model, KS for Thin-file consumer = 1.00)



Source: Previously unpublished findings from *Give Credit Where Credit is Due*

Since the groups of consumers in the comparisons are different, one should not extrapolate too much from these results, such as slightly better predictions can be made from some types of consumers with some types of data. What can likely be safely taken from this is that model performance appears to be roughly comparable across groups and that alternative data appears to be predictive for no credit and new to credit consumers. Whether alternative data is as predictive as traditional data or how predictive the data is relative to traditional data are questions that require further investigation (likely to be carried out by lenders interested in determining how exactly alternative data can be optimally used when extending credit to those new to credit). Nonetheless, these findings combined with (a) regression and correlation analysis and (b) the thin-file and general KS calculations detailed in *Give Credit Where Credit Is Due* provides strong evidence that alternative data is predictive of payment outcomes in general, and for the subset of consumers that are thin-file and new to credit¹⁶.

These results provided the basis for PERC's 2008 follow-up study, *You Score, You Win: The Consequences of Giving Credit Where Credit is Due*¹⁷, in which the payment behavior of new to credit consumers is examined as additional credit lines are extended to them. That study examines the ways in which consumers respond to new credit and the longer term effects of using alternative data.



¹⁶ See pages 28 and 29 of *Give credit Where Credit Is Due*.

¹⁷ Turner et al. (2008) *You Score, You Win: The Consequences of Giving Credit Where Credit is Due* PERC.

III. How do new to credit consumers cope with increased credit access?

A recurring concern for the new to credit consumer class is their vulnerability to over-extension, which may result in defaulting on loans, or worse. *You Score, You Win* establishes that new to credit consumers who are aided by alternative data open new accounts at a much higher rate than do thin-file consumers with no alternative data trade lines¹⁸. The PERC study sample showed increased access to credit and a slight overall increase in credit score for new to credit consumers whose score was calculated using alternative data¹⁹. This is the known short-term effect of the use of alternative data. *You Score, You Win* examines the impacts of using alternative data upon credit scores over time.

This study compared credit scores and changes in credit scores over a one year period for two groups of consumers. One group had only alternative data prior to March 2005 and subsequently opened one or more new accounts. The other had only alternative data prior to March 2003 and subsequently opened a new account. Since we have scores for these groups in March 2006, the first group had less than a year of experience with new accounts and the second group had one to three years of experience with new accounts. This provided the first quantitative results

demonstrating that the use of alternative data not only helps new to credit consumers establish a credit history and access affordable mainstream credit, but also that for a majority their scores actually *increase* over time. This and the earlier study leads to three major findings:

- » Alternative data enables an out-cast class of consumer to establish a credit history without taking on debt in order to gain access to credit.
- » Using alternative data as an input in determining risk provides enough information for creditors to make good choices in determining creditworthiness for some types of credit.
- » Consumers are not becoming over-extended through offers of new credit. *The patterns of payment established by consumers in the non-traditional sector are indicative of consumer behavior in the traditional credit sector.*

¹⁸ Tradelines are defined as accounts contained in a credit file.

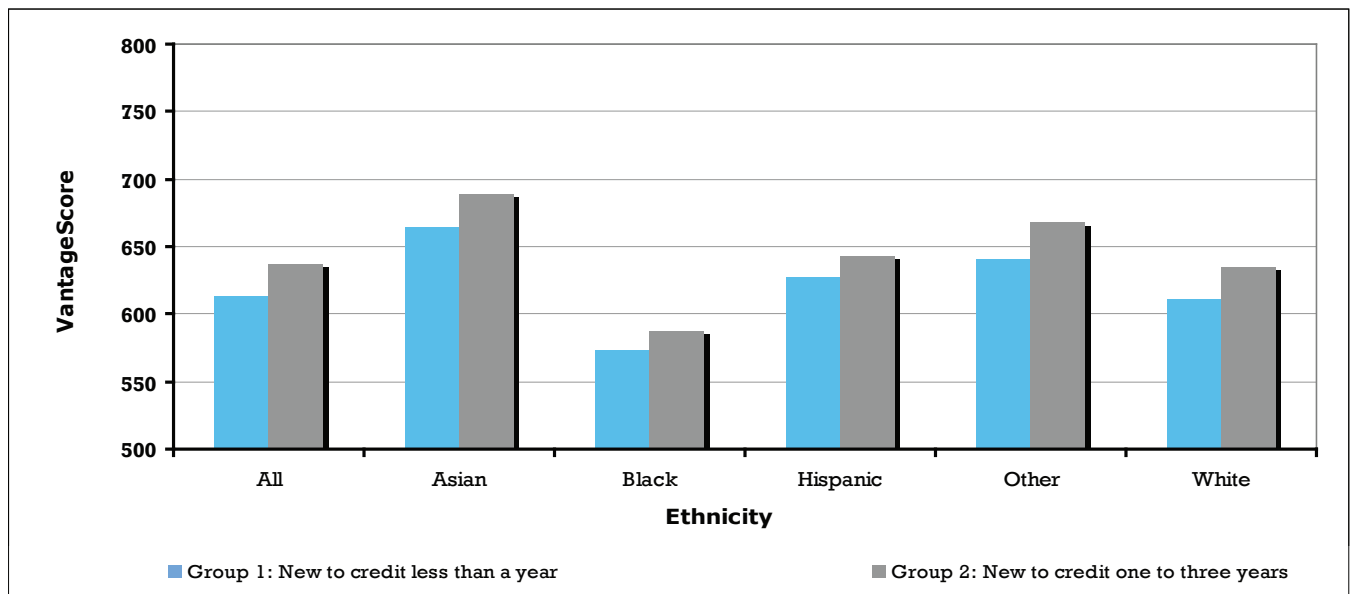
¹⁹ Turner et al. (2008) *You Score, You Win: The Consequences of Giving Credit Where Credit is Due* PERC.

IV. How do different segments perform?

Figures 7 and 8 reveal that as consumers with only alternative data in their credit file open new accounts that their credit scores tend to rise over time. This appears to be the case for all ethnic and household income groups examined, except for those with household incomes over \$99,000. For this segment there appears to be

virtually no difference in credit scores between the groups. These results provide no evidence for the concern that those who are new to credit via alternative data would, on average, experience increased financial and credit difficulties over time. Though not shown, additional results from *You Score, You Win*, reveals that those in Group 1 had approximately the same credit score prior to opening the new account.²⁰

FIGURE 7: Average Score Difference Between Groups with Different Lengths of Experiences Being New to Credit, by Ethnicity²¹

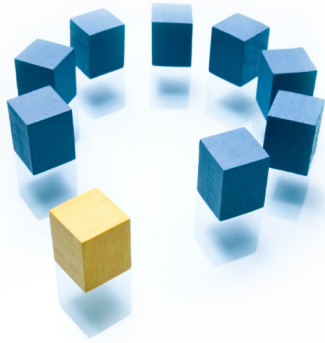


Source: Turner et al. (2008) *You Score, You Win: The Consequences of Giving Credit Where Credit is Due* PERC, 24.

²⁰The average score prior to opening the new accounts was lower by less than a point.

²¹Group 1 are consumers with only alternative trades prior to March 2005 that subsequently opened an additional trade between March 2005 and March 2006.

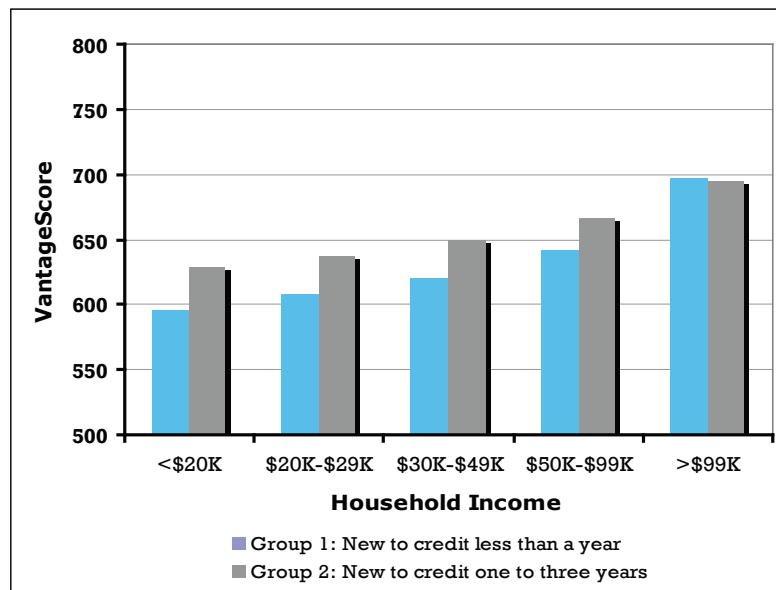
Group 2 are consumers with only alternative trades prior to March 2003 that subsequently opened a traditional trade between March 2003 and March 2005.



A third group looked at in *You Score, You Win* was consumers who had alternative data and only one traditional payment history for over three years. The average credit score for this group was 660, about 23 points greater than the average for Group II. We

conclude that for consumers who have only alternative data and subsequently open a new traditional account, there appears to be no immediate decline in their credit score and over time their credit scores appear to rise. Only a more controlled experiment following the same group of consumers over time could determine why this is occurring. Perhaps the longer credit history improves their score or perhaps the different groups examined have underlying differences (the groups with the more experience may be older on average). Nonetheless, we find no evidence that gaining access to mainstream credit via alternative data on average harms consumers. On the contrary, the access itself combined with score changes over time suggest that, on average, consumers benefit.

FIGURE 8: Average Score Differences Between Groups with Different Lengths of Experiences Being New to Credit, by Household Income



Source: Turner et al. (2008) “*You Score, You Win: The Consequences of Giving Credit Where Credit is Due*” PERC, 24.



V. How does this affect lender portfolio?

Give Credit Where Credit is Due establishes that on the whole, the use of alternative data in the credit scoring rubric does not worsen credit scores for most borrowers in the short-term. The key benefit is that many who were unscorable became scoreable, and many received prime scores. And the scores that incorporated alternative data were more predictive of payment outcomes -- that is, outperformed -- the scores generated without alternative data. Using the alternative data would allow lenders to increase the size of their portfolios, reduce delinquency rates, or some combination of the two. In short, alternative data enables lenders to better assess consumer risk and make better lending decisions.

You Score, You Win shows that the use of alternative data also does not, on average, worsen credit scores over time. This suggests these consumers are not becoming overextended. The evidence shows that these consumers are able to leverage their new scores into mainstream credit access. This suggests that over the longer term, consumers gaining access to credit via alternative data are not becoming increasingly overextended or experiencing increasing payment and credit difficulties. Rather, credit scores tend to rise over time for those who access credit based on alternative data.

Taken together these results imply that by using alternative data in underwriting, lenders can extend credit to many that would have previously been excluded, make better lending decisions for thin-file consumers in general, and at the same time not fear long-term negative impacts on their portfolios.

Whenever any new approach is taken in lending, it is prudent to first thoroughly test the new approach. And we certainly recommend the usual sorts of lending analysis as are highlighted for the case of using alternative data in *Using non-traditional data for underwriting loans to thin-file borrowers: Evidence, tips, and precautions*²².

²²Turner, Michael and Amita Agarwal. "Using non-traditional data for underwriting loans to thin-file borrowers: Evidence, tips, and precautions". *Journal of Risk Management in Financial Institutions*. 1:2, pp.165-180. Available: <http://www.infopolicy.org/files/downloads/pp165-80.pdf>



VI. Conclusion

Given the current credit crisis, PERC's research on alternative data identifies timely opportunities for both the underserved consumer market and lenders. Lenders will be able to use non-financial information to extend credit to the financially excluded. A Fair Isaac Corporation estimate predicts that if just 3% of the underserved market is accessed via the risk information that alternative data provides, the benefit to lenders would be substantial, equaling approximately \$2.3 billion for mortgage lenders, \$750 million for automobile lenders, and \$113 million for credit card issuers²³. If GE Money's estimate that 40% of the thin-file/

no-file population can be extended credit profitably using current credit instruments, this would mean \$30.67 billion for mortgage lenders, roughly \$10 billion for automobile lenders, and \$1.5 billion for credit card issuers²⁴.

The real beneficiaries, however, are the credit underserved. With access to affordable and responsible credit, new to credit consumers are able to build assets. Those financially underserved consumers who have a positive payment records in non-financial obligations will have the ability to access affordable credit. Importantly, this can be done without having to take on credit. It enables individuals to break free from the "credit Catch 22" of having to have credit experience in order to qualify from credit.

Additionally, consumers who do not pay on time are protected from receiving offers of credit that would cause them financial hardship. That is, fully reporting non-financial payment obligations to credit bureaus and CRAs offers both compelling consumer benefits—access to affordable mainstream credit—and powerful consumer protections—credit offers that match a borrower's capacity to repay.

²³Maas, Erica. (2008) "Credit scoring and the credit-underserved population" The Federal Reserve Bank of Minneapolis. (16 Sep 2008) Available: http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=2452.

²⁴These figures are derived by multiplying FICO's estimates based upon 3% of the underserved. These figures are derived by multiplying FICO's estimates based upon 3% of the underserved population by 13.333 to adjust for GE Money's estimate that 40% of the thin-file/no-file population could qualify for credit using existing credit instruments. GE Money estimate from transcript of event at Brookings Institution titled "Extending Credit: Helping Americans Build Solid Financial Futures." Downloaded from: <http://www.brookings.edu/~media/Files/events/2007/0109metropolitan%20policy/20070109.pdf>

Widespread reporting of non-financial payment obligations to credit bureaus and CRAs is much needed in the wake of the recent US financial crisis whereby various parties either misused or failed to use credit information appropriately for assessing risk. Broadening the quantity of verifiable payment data in a credit file should go a long way toward making lending broader, faster, and smarter. Reporting alternative data to consumer credit bureaus and CRAs is not a magic bullet solution to today's credit crunch and financial crisis, but it is one powerful tool that can be used to repair and rebuild a devastated retail credit sector.



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Credit Report Accuracy and Access to Credit

Robert B. Avery, Paul S. Calem, and Glenn B. Canner, of the Board's Division of Research and Statistics, prepared this article. Shannon C. Mok provided research assistance.

Information that credit-reporting agencies maintain on consumers' credit-related experiences plays a central role in U.S. credit markets. Creditors consider such data a primary factor when they monitor the credit circumstances of current customers and evaluate the creditworthiness of prospective borrowers. Analysts widely agree that the data enable domestic consumer credit markets to function more efficiently and at lower cost than would otherwise be possible.

Despite the great benefits of the current system, however, some analysts have raised concerns about the accuracy, completeness, timeliness, and consistency of consumer credit records and about the effects of data limitations on the availability and cost of credit. These concerns have grown as creditors have begun to rely more on "credit history scores" (statistical characterizations of an individual's creditworthiness based exclusively on credit record information) and less on labor-intensive reviews of the detailed information in credit reports. Moreover, decision-makers in areas unrelated to consumer credit, including employment screening and underwriting of property and casualty insurance, increasingly depend on credit records, as studies have shown that such records have predictive value.

A previous article in this publication examined in detail the credit records of a large, nationally representative sample of individuals as of June 30, 1999.¹ That analysis revealed the breadth and depth of the information in credit records. It also found, however, that key aspects of the data may be ambiguous, duplicative, or incomplete and that such limitations have the potential to harm or to benefit consumers.

Although the earlier analysis contributed to the debate about the quality of the information in credit records, it did not attempt to quantify the effects of data limitations on consumers' access to credit. To

date, publicly available information about the extent of data quality problems has been limited, as has research on the effects of those problems.² The lack of information has inhibited discussion of the problems and of the appropriate ways to address them.

The main reason for the lack of information is that conducting research on the effects of data limitations on access to credit is complicated. Two factors account for the complexity. First, the effects vary depending on the overall composition of the affected individual's credit record. For example, a minor error in a credit record is likely to have little or no effect on access to credit for an individual with many reported account histories, but the same error may have a significant effect on access to credit for someone with only a few reported account histories. Second, assessments of the effects of data limitations require detailed knowledge of the model used to evaluate an individual's credit history and of the credit-risk factors that compose the model. Because information about credit-scoring models and their factors is ordinarily proprietary, it is difficult to obtain.

In this article, we expand on the available research by presenting an analysis that tackles these complexities and quantifies the effects of credit record limitations on the access to credit.³ The analysis considers the credit records of a nationally representative sample of individuals, drawn as of June 30, 2003, that incorporates improvements in the reporting system over the past few years and, consequently, better reflects today's circumstances. We examine the possible effects of data limitations on consumers by estimating the changes in consumers' credit history scores that would result from "correcting" data problems in their credit records. We also investigate

2. General Accounting Office (2003), *Consumer Credit: Limited Information Exists on Extent of Credit Report Errors and Their Implications for Consumers*, report prepared for the Senate Committee on Banking, Housing, and Urban Affairs, GAO-03-1036T, July 31, pp. 1–18. In 2004, the General Accounting Office became the Government Accountability Office.

3. This analysis builds on recent research that attempted to quantify the effects of credit record limitations on the access to credit. See Robert B. Avery, Paul S. Calem, and Glenn B. Canner (2003), "Credit Reporting and the Practical Implications of Inaccurate or Missing Information in Underwriting Decisions," paper presented at "Building Assets, Building Credit: A Symposium on Improving Financial Services in Low-Income Communities," Joint Center for Housing Studies, Harvard University, November 18–19.

1. Robert B. Avery, Raphael W. Bostic, Paul S. Calem, and Glenn B. Canner (2003), "An Overview of Consumer Data and Credit Reporting," *Federal Reserve Bulletin*, vol. 89 (February), pp. 47–73.

whether different patterns emerge when individuals in the sample are grouped by strength of credit history (credit history score range), depth of credit history (number of credit accounts in a credit record), and selected demographic characteristics (age, relative income of census tract of residence, and percentage of minorities in census tract of residence). Such segmentation allows us to determine whether the effects of data limitations differ for various subgroups of the population.

CONSUMER CREDIT REPORTS

A consumer credit report is the organized presentation of information about an individual's credit record that a credit-reporting agency communicates to those requesting information about the credit history of an individual. It includes information on an individual's experiences with credit, leases, non-credit-related bills, collection agency actions, monetary-related public records, and inquiries about the individual's credit history. Credit reports, along with credit history scores derived from the records of credit-reporting agencies, have long been considered one of the primary factors in credit evaluations and loan pricing decisions. They are also widely used to select individuals to contact for prescreened credit solicitations. More recently, credit reports and credit history scores have often been used in identifying potential customers for property and casualty insurance and in underwriting and pricing such insurance.⁴

The three national credit-reporting agencies—Equifax, Experian, and Trans Union—seek to collect comprehensive information on all lending to individuals in the United States, and as a consequence, the information that each agency maintains is vast. Each one has records on perhaps as many as 1.5 billion credit accounts held by approximately 210 million individuals.⁵ Together, these agencies generate more than 1 billion credit reports each year, providing the vast majority of the reports for creditors, employers, and insurers. One study found that con-

sumers receive only about 16 million of the credit reports distributed each year.⁶

Credit-reporting agencies collect information from “reporters”—creditors, governmental entities, collection agencies, and third-party intermediaries. They generally collect data every month, and they typically update their credit records within one to seven days after receiving new information. According to industry sources, each agency receives more than 2 billion items of information each month. To facilitate the collection process and to reduce reporting costs, the agencies have implemented procedures to have data submitted in a standard format, the so-called Metro format.⁷ Data may be submitted through various media, including CD-ROM and electronic data transfer. Reporters submit information voluntarily: No state or federal law requires them to report data to the agencies or to use a particular format for their reporting. As a result, the completeness and frequency of reporting can vary.

Using Credit Records to Evaluate Creditworthiness

In developing credit history scores, builders of credit-scoring models consider a wide variety of summary factors drawn from credit records. In most cases, the factors are constructed by combining information from different items within an individual's credit record. These factors compose the key elements of credit models used to generate credit history scores. Although hundreds of factors may be created from credit records, those used in credit-scoring models are the ones proven statistically to be the most valid predictors of future credit performance. The factors and the weights assigned to each one can vary across evaluators and their different models, but the factors generally fall into four broad areas: payment history, consumer indebtedness, length of credit history, and the acquisition of new credit.⁸

4. For purposes of insurance, the scores are typically referred to as insurance scores.

5. John A. Ford (2003), chief privacy officer of Equifax, Inc., in *Fair Credit Reporting Act: How It Functions for Consumers and the Economy*, hearing before the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services, House Hearing 108-33, 108 Cong. 2 Sess. (Washington: Government Printing Office), June 4. Also see Consumer Data Industry Association (formerly Associated Credit Bureaus), “About CDIA,” www.cdiaonline.org.

6. Loretta Nott and Angle A. Welborn (2003), *A Consumer's Access to a Free Credit Report: A Legal and Economic Analysis*, report to the Congress by the Congressional Research Service, September 16, pp. 1–14.

7. Currently, reporters may submit data in the Metro I or Metro II format. As of 2005, the Metro II format will be required for all submissions.

8. For a more detailed discussion of factors considered in credit evaluation, including the relative weights assigned to different factors, see the description on the website of Fair Isaac Corporation, www.myfico.com. Also see Robert B. Avery, Raphael W. Bostic, Paul S. Calem, and Glenn B. Canner (1996), “Credit Risk, Credit Scoring, and the Performance of Home Mortgages,” *Federal Reserve Bulletin*, vol. 82 (July), pp. 621–48.

Payment History

The most important factors considered in credit evaluation are those that relate to an individual's history of repaying loans and any evidence of non-credit-related collections or money-related public actions. Credit evaluators consider whether an individual has a history of repaying balances on credit accounts in a timely fashion. The analysis takes into account not only the frequency of any repayment problems but also their severity (lateness), date of occurrence (newness), and dollar magnitude. Evaluators assess repayment performance on the full range of accounts that an individual holds, distinguishing accounts by type (such as revolving, installment, or mortgage) and by source (such as banking institution, finance company, or retailer). In general, an individual with serious deficiencies in repayment performance, such as a credit account that is currently delinquent, will find qualifying for new credit difficult, may face higher interest rates for the credit received, or may be limited in further borrowing on existing revolving accounts.

Consumer Indebtedness

When evaluating credit, creditors consider the type and amount of debt an individual has and the rate of credit utilization. For revolving accounts, the rate of credit utilization is measured as the proportion of available credit in use (outstanding balance divided by the maximum amount the individual is authorized to borrow, referred to as the credit limit). For installment and mortgage accounts, credit utilization is generally measured as the proportion of the original loan amount that is unpaid. High rates of credit utilization are generally viewed as an additional risk factor in credit evaluations, as they may indicate that an individual has tapped all available credit to deal with a financial setback, such as a loss of income.

Length of Credit History

Credit evaluators consider the length of a person's credit history because it provides information about how long the individual has been involved in credit markets and about whether he or she has obtained credit recently. The age of the account is relevant to an evaluation of credit quality because the longer the account has been open, the more information it con-

veys about an individual's willingness and ability to make payments as scheduled. New accounts may convey little information other than that a consumer has had a recent need for additional credit and has been approved for credit.

Acquisition of New Credit

Whether a person is seeking new credit provides information about the credit risk posed by the individual. The number of new accounts the individual has recently established and the number of attempts to obtain additional loans, as conveyed by records of recent creditor inquiries (requests for credit reports), all provide a picture of the individual's recent credit profile.⁹ Attempts to open a relatively large number of new accounts may signal that a person risks becoming overextended.

Calculating a Credit History Score

Statistical modelers working with data from credit-reporting agencies construct credit history scores using selected factors of the types described above. Modelers divide each factor into ranges and assign each range a point count. The score for an individual is the sum of these points over all factors considered in the model. Typically, the points and the factors used in the model are derived from a statistical analysis of the relationship between the factors at an initial date and the credit performance over a subsequent period.

Role of the Fair Credit Reporting Act

Although participation by reporters in the credit-reporting process is voluntary, reporters are subject to rules and regulations spelled out in the Fair Credit Reporting Act (FCRA). The FCRA regulates access to credit information and prescribes how the agencies are to maintain each credit report they hold.¹⁰ Under the FCRA, only persons with a permissible pur-

9. Inquiries made to create a mailing list for sending prescreened solicitations or to monitor existing account relationships are omitted from the credit reports. Also omitted are individuals' requests for copies of their own reports.

10. For a discussion of how the FCRA governs and encourages accurate credit reporting, see Michael Staten and Fred Cate (2003), "Does the Fair Credit Reporting Act Promote Accurate Credit Reporting?" paper presented at "Building Assets, Building Credit: A Symposium on Improving Financial Services in Low-Income Communities," Joint Center for Housing Studies, Harvard University, November 18–19.

Provisions of the Fair and Accurate Credit Transactions Act of 2003

The Fair and Accurate Credit Transactions Act of 2003 amended the Fair Credit Reporting Act in several ways. The amendments, known collectively as the FACT Act, seek to (1) improve the use of credit information and give consumers greater access to such information, (2) prevent identity theft and facilitate credit history restitution, (3) enhance the accuracy of consumer report information, (4) limit the sharing and use of medical information in the financial system, and (5) improve financial literacy and education.

The amendments that address the use and availability of credit information provide the following consumer rights and protections:

- **The right to obtain a free copy of a consumer report.** A consumer may request a free credit report once a year from each of the national credit-reporting agencies, and each agency must establish a toll-free telephone number to receive the requests. A consumer may also obtain a credit history score and related information from each agency for a “fair and reasonable” fee. For a given credit history score, related information includes the range of possible scores under the model used to produce the score, a list of the key factors (not to exceed four) that adversely affected the score, the date the score was established, and the name of the entity that provided the score.
- **The right to be told when, as a result of negative information in a credit report, a creditor has offered a consumer credit on terms that are materially less favorable than those offered to most other consumers.** At the time of notification, the creditor must provide a statement that explains the consumer’s right to obtain a free credit report from a credit-reporting agency and that provides contact information for obtaining the report (as of this writing, the rules for implementing this provision were not yet final).
- **Protection against faulty reporting of credit record data.** Federal supervisors of financial institutions must establish and maintain guidelines regarding the accuracy and integrity of the information that data reporters submit to credit-reporting agencies. In certain circumstances, a data reporter must reinvestigate a dispute involving the information it reported.

pose for obtaining a credit report—for example, to facilitate a credit transaction, to screen prospective employees, or to underwrite property and casualty insurance involving a consumer—may have access to this credit information. The FCRA prohibits a

from furnishing information credit-

11. About 85 percent of the credit reports that consumers receive each year are associated with adverse actions. See Nott and Welborn, *A Consumer’s Access to a Free Credit Report*, p. 10.

12. For example, if a reporter submits a file that includes a much larger or a much smaller number of records than have historically been received, then the agency will flag the file for review. Similarly, if an unexpectedly large or an unexpectedly small percentage of the data items have a given characteristic (for example, the number of accounts sixty or more days late exceeds a designated threshold), then the agency will also flag the data for review.

potential for error. For example, because data reporting is voluntary and because the ability of the agencies to enforce certain standards is limited, the agencies have had to devise techniques for recognizing that sometimes data items reported with the same identifying information, such as the same name, may actually be associated with different individuals. Similarly, a social security number may be missing from or may be reported incorrectly in reported information on an individual. In such cases, the likelihood of associating the reported item with the wrong person increases significantly.

Although the agencies' data are extensive, they are incomplete in two respects. First, not all information on credit accounts held by individuals is reported to the agencies. Some small retailers and mortgage and finance companies do not report to the agencies, and individuals, employers, insurance companies, and foreign entities typically do not report loans they extend. Also, information on student loans is not always reported. Second, some accounts that are reported contain incomplete or out-of-date information. Sometimes creditors do not report or update information on the credit accounts of consumers who consistently make their required payments as scheduled or on the accounts of those who have been seriously delinquent in their payments, particularly accounts with no change in status. Similarly, credit limits established on revolving accounts, such as credit cards, are not always reported or updated. Moreover, creditors may not notify the agencies when an account has been closed, transferred, or assigned a new payment status. For example, sometimes creditors fail to report delinquent payments that are fewer than thirty or sixty days past due, and they report changes in payment status only when a more serious payment problem arises. Each of these possibilities contributes to problems of data completeness and integrity, and each has the potential to compromise the evaluation of an individual's creditworthiness.

Another problem that may compromise credit evaluations concerns the timeliness of the data. The information reported on credit accounts reflects each account's payment status and outstanding balance as of a date shortly before the information is forwarded to the agencies. Thus, the information is sensitive to the date on which the information is forwarded. For example, a credit account reported the day after a creditor has posted a payment to the account will show a smaller balance than will the same account reported the day before the posting. Similarly, the payment status reflected in a credit report is sensitive to timing; the record on an account may indicate no

late payment problems on a given day but may show a delinquency if reported to the agency one or two days later.

Besides the accuracy, completeness, and timeliness of information in a given credit record, the consistency of information about an individual across agencies is an issue of concern. The information may differ from agency to agency for several reasons. First, the rules governing the processing of reported information differ across agencies. For example, each agency has its own rules for determining whether identifying information is sufficient to link reported information to a single individual. The inability to link reported information accurately in all cases can be an important source of data quality concerns because it results in the creation of "fragmentary files"—that is, multiple and therefore incomplete credit reports for the same individual—and sometimes in the assignment of the wrong credit records to an individual. Fragmentary files often result because consumers use different addresses or names (for example, after a marriage or a divorce), in some cases fraudulently, to obtain credit or other services. Each agency also has its own rules governing the treatment of out-of-date information, such as accounts last reported to have a positive balance. Second, the agencies receive and post information at different times. Third, a given reporter may provide information to one or two of the agencies but not to all three. Finally, changes made to disputed information may be reflected only in the credit records of the agency that received the disputed claim.

Although the agencies endeavor to maintain high-quality data and accurate files, the degree to which consumer credit reports are accurate, complete, timely, or consistent across agencies is in dispute. Moreover, analysts disagree on the extent to which data errors and omissions affect credit history scores. A recent analysis by the General Accounting Office (GAO) cites information drawn from the relatively few studies that have attempted to address data accuracy and importance.¹³ Specifically, the GAO cites a 2002 joint study by the Consumer Federation of America and the National Credit Reporting Association that found evidence that the information included in the credit reports of any given individual can differ widely across agencies.¹⁴ This study also found that credit history scores based on data from the agencies can vary substantially regardless of whether the individual has a generally good or a generally bad credit

13. General Accounting Office, *Consumer Credit*.

14. Consumer Federation of America and National Credit Reporting Association (2002), *Credit Score Accuracy and Implications for Consumers*, December 17, www.consumerfed.org.

history. As a consequence, the study concluded, “millions of consumers are at risk of being penalized by inaccurate credit report information and inaccurate credit scores.”¹⁵

The GAO report also discusses research on errors and omissions that occur within the credit files of a single agency. The report highlights different perspectives on the data quality issue. For example, one investigation by a consumer organization estimated that up to 79 percent of credit reports may contain some type of error and that about 25 percent of all consumer credit reports may contain errors that can result in the denial of access to credit.¹⁶ A study by Arthur Andersen and Company reviewing the outcomes for individuals who were denied credit and then disputed information in their credit reports concluded, however, that only a small proportion of the individuals were denied credit because of inaccurate information in their credit reports.¹⁷

THE FEDERAL RESERVE SAMPLE OF CREDIT RECORDS

The Federal Reserve Board obtained from one of the three national credit-reporting agencies the credit records (excluding any identifying personal or creditor information) of a nationally representative random sample of 301,000 individuals as of June 30, 2003.¹⁸ The sample data omitted home addresses but

included census tracts, states, and counties of residence. We used this geographic information with census 2000 files—which provide population characteristics, such as income, race, and ethnicity, by census tract of residence—to analyze the credit record data.

Four general types of credit-related information appear in credit records, including those in the Federal Reserve sample: (1) detailed information from creditors (and some other entities such as utility companies) on credit accounts—that is, current and past loans, leases, and non-credit-related bills; (2) information reported by collection agencies on actions associated with credit accounts and non-credit-related bills, such as unpaid medical or utility bills; (3) information purchased from third parties about monetary-related public records, such as records of bankruptcy, foreclosure, tax liens (local, state, or federal), lawsuits, garnishments, and other civil judgments; and (4) information about inquiries from creditors regarding an individual’s credit record.

Credit accounts constitute the bulk of the information in the typical individual’s credit record, and thus they compose the bulk of the information that the agencies maintain. Credit account records contain a wide range of details about each account, including the date that an account was established; the type of account, such as revolving, installment, or mortgage; the current balance owed; the highest balance owed; credit limits if applicable; and payment performance information, such as the extent to which payments are or have been in arrears for accounts in default.

A basic element of agency data is information on the open or closed status of each account. An account is considered open if a credit relationship is ongoing and closed if the consumer can no longer use the account. Another important element of account information is the date on which the information was most recently reported. The date is critical in determining whether the information on the account in the credit agency files is current or stale (unreported for some time and therefore potentially in need of updating).

Significantly less-detailed information is available on collection agency accounts, public records, and creditor inquiries about a consumer’s credit history. Generally, only the amount of the collection or public record claim, the name of the creditor, and the date last reported are available. For creditor inquiries, information is even more limited and includes just the type of inquirer and the date of the inquiry. The

15. Consumer Federation of America and National Credit Reporting Association, *Credit Score Accuracy and Implications for Consumers*. The study found that the difference between the high and the low credit history scores for an individual across the three agencies averaged 41 points (on a scale of 300 to 850) and that about 4 percent of individuals had score differences of 100 points or more.

16. Alison Cassady and Edmund Mierzwinski (2004), *Mistakes Do Happen: A Look at Errors in Consumer Credit Reports*, National Association of State Public Interest Research Groups, June, www.uspirg.org. Also see Jon Golinger and Edmund Mierzwinski (1998), *Mistakes Do Happen: Credit Report Errors Mean Consumers Lose*, U.S. Public Interest Research Group, March, www.uspirg.org.

17. Consumer Data Industry Association (1998), press release, March 12, www.cdiaonline.org. Also see Robert M. Hunt (2002), “The Development and Regulation of Consumer Credit Reporting in America,” Working Paper No. 02-21 (Philadelphia: Federal Reserve Bank of Philadelphia, November). The study found that 8 percent of the consumers who were denied credit requested copies of their credit reports. Of these consumers, 25 percent found and disputed errors. Of those consumers who found errors, about 12 percent (3 percent of those who requested credit reports) eventually received credit because of favorable dispute resolutions.

18. Agency files include personal identifying information that enables the agencies to distinguish among individuals and construct a full record of each individual’s credit-related activities. The records received by the Federal Reserve excluded the personal identifying information that agency files contain—the consumer’s name, current and previous addresses, and social security number—as well as other personal information that credit files sometimes contain—telephone

numbers, name of spouse, number of dependents, income, and employment information. Under the terms of the contract with the credit-reporting agency, the data received by the Federal Reserve cannot be released to the public.

1. Individuals with credit-reporting agency records, by type of information in credit record, as of June 30, 2003

Type of information in credit record	Number	Share of sample (percent)
Sample size	301,536	100.0
Credit account	259,211	86.0
Collection agency account	109,964	36.5
Public record	36,742	12.2
Creditor inquiry ¹	188,616	62.6
None of the above	15	*
MEMO		
Credit account only	63,501	21.1
Collection agency account only	34,978	11.6
Public record only	53	*
Creditor inquiry only ¹	31	*
Credit account and		
Collection agency account	67,747	22.5
Public record	34,715	11.5
Creditor inquiry ¹	182,553	60.5

NOTE. In this and subsequent tables, components may not sum to totals because of rounding.

1. Item includes only inquiries made within two years of the date the sample was drawn.

* Less than 0.5 percent.

agencies generally retain inquiry information for twenty-four months.

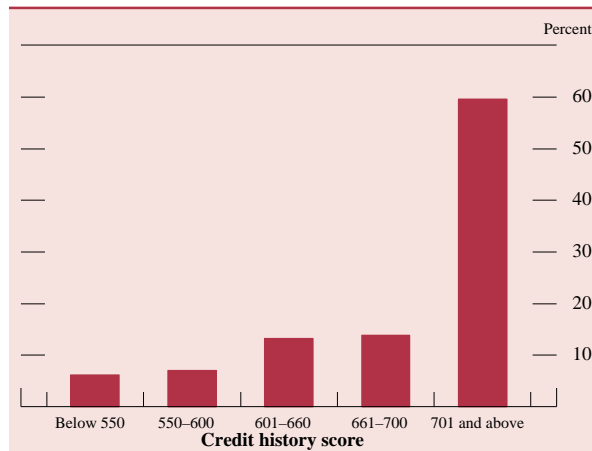
In aggregate, the Federal Reserve sample contained information on about 3.7 million credit accounts, more than 318,000 collection-related actions, roughly 65,000 monetary-related public record actions, and about 913,000 creditor inquiries. Not every individual had information of each type. In the sample, approximately 260,000, or 86 percent, of the individuals had records of credit accounts as of the date the sample was drawn (table 1).¹⁹ Although a large portion of individuals had items indicating collection agency accounts, public record actions, or creditor inquiries, only a very small share (well less than 1 percent) of the individuals with credit records had only public record items or only records of creditor inquiries. However, for about 12 percent of the individuals, the only items in their credit records were collection actions.

Credit History Scores in the Sample

The credit-reporting agency provided credit history scores for about 250,000, or 83 percent, of the individuals in the sample. The agency used its propri-

19. The credit account information was provided by 92,000 reporters, 23,000 of which had reported within three months of the date the sample was drawn.

1. Distribution of individuals, by credit history score



NOTE. Data are from a Federal Reserve sample drawn as of June 30, 2003. The distribution is composed of individuals in the sample who had been assigned credit history scores. Authors have adjusted the scores, which are proprietary, to match the distribution of the more familiar FICO credit history scores, developed by Fair Isaac Corporation.

etary credit-risk-scoring model as of the date the sample was drawn to generate the scores (one for each individual), which it constructed from selected factors of the type described previously. The proprietary credit-risk score is like other commonly used consumer credit history scores in that larger values indicate greater creditworthiness. The agency did not assign scores to anyone who did not have a credit account. A small proportion of individuals without scores did have credit accounts, but most of these individuals were not legally responsible for any debt owed.

To facilitate this discussion, we have adjusted the proprietary credit-risk scores assigned to individuals in the Federal Reserve sample to match the distribution of the more familiar FICO credit history scores, for which information is publicly available.²⁰ Among the individuals in our sample who had scores, about 60 percent had adjusted scores of 701 or above (chart 1). Individuals with FICO scores in this range are relatively good credit risks. According to Fair Isaac Corporation, less than 5 percent of such con-

20. For a national distribution of FICO scores, see www.myfico.com/myfico/creditcentral/scoringworks.asp. All three agencies use versions of the FICO score, which is generated from software developed by the Fair Isaac Corporation. Each agency gives the score a different name. Equifax calls it the Beacon score; Experian, the Experian/Fair Isaac Risk score; and Trans Union, the Empirica score. In developing the scores, Fair Isaac used the same methods at each agency but estimated the FICO model differently at each one, using separate samples. Thus, just as the information about an individual can differ across the three companies, so can the FICO model.

sumers are likely to become seriously delinquent on any debt payment over the next two years.²¹ In contrast, about 13 percent of individuals in our sample had adjusted scores at or below 600. According to Fair Isaac, more than half of these consumers are likely to become seriously delinquent on a loan over the next two years.

Because credit history scores can be used to measure credit risk, creditors use them, along with other measures of creditworthiness, such as collateral, income, and employment information, to determine whether to extend credit and, if so, on what terms. Credit history scores are closely aligned with the interest rates offered on loans—that is, higher scores are associated with lower interest rates. For example, as of August 30, 2004, the national average interest rate for a thirty-year fixed-rate conventional mortgage for an individual with a FICO score of 720 or more was 5.75 percent, whereas the average interest rate for someone with a score below 560 was 9.29 percent.²²

Assessing the Effects of Data Limitations

The analysis to assess the potential effects of data limitations on an individual's access to credit involves two steps: identifying data problems in an individual's credit record and simulating the effects of "correcting" each problem on the availability or price of credit as represented by the change in the individual's credit history score. To conduct this exercise, one must know (1) the factors used to construct the score, (2) the points assigned to these factors in deriving an individual's score, and (3) the process used to create the underlying factors from the original credit records.

The Federal Reserve's sample includes all the information that would be necessary to construct any credit history score and its underlying factors from the original credit records. However, the details of the credit-reporting agency's credit-scoring model, including the factors and point scales used in the model, are proprietary and were not made available to the Federal Reserve. Nevertheless, we were able to approximate the model by using three types of infor-

mation: (1) the proprietary credit-risk score assigned to each individual in our sample; (2) a large set of credit factors for each individual—a subset of which was known to comprise the factors used in the proprietary credit-scoring model; and (3) detailed account-level information in each individual's credit record. We used the first two items to construct an approximation of the proprietary credit-scoring model, employing regression techniques to estimate the points to assign to each factor. We used the second and third items to "reverse-engineer" the credit factors included in our version of the credit-scoring model. This information enabled us to recalculate how the factors—and ultimately the credit history scores—would change if alterations were made to the underlying credit records so that we could simulate the effects of correcting a data problem or omission.

Because of the numerous potential factors and specifications that could have been used to construct the proprietary credit-risk score, our version of the credit-scoring model undoubtedly differs from the actual proprietary model. However, we were able to identify almost exactly the process used to construct the factors in the actual model from the underlying credit records. Moreover, the approximated and actual model scores corresponded quite closely. Thus, we believe that our approximation of the scoring process provides a reasonable estimate of the potential effects of a change in a credit record item on an individual's credit history score.

Other model builders consider different credit-risk factors in creating their scoring models, assign different points to the factors, and employ different rules for constructing the factors. As a consequence, even if we had identified the proprietary model exactly, the results of our analysis would not necessarily have been the same as those implied by other models. Nevertheless, our results should be viewed as indicative of the implications of data quality issues for scoring models in general and as applicable in many, if not all, respects.

DATA QUALITY ISSUES

As noted earlier, a previous article in this publication examined in detail the credit records of a sample of individuals as of June 30, 1999, and found that key aspects of the data were ambiguous, duplicative, or incomplete. The article highlighted four areas of concern: (1) The current status of "stale" accounts, which show positive balances (amounts owed that are greater than zero) but are not currently reported, is ambiguous; (2) some creditors fail to report

21. The term "seriously delinquent" means falling behind on a loan payment ninety days or more, defaulting on a loan, or filing for bankruptcy.

22. See www.myfico.com. Loan rate includes 1 discount percentage point and is based on a loan amount of \$150,000 for a single-family, owner-occupied property and on an 80 percent loan-to-value ratio. As the data on the web site show, interest rates vary little by credit history score for individuals with scores above 700.

credit account information, including nonderogatory accounts (accounts whose payments are being made as scheduled) or minor delinquencies (accounts 30 to 119 days in arrears); (3) credit limits are sometimes unreported; and (4) the reporting of data on collection agency accounts and public records may be inconsistent or may contain redundancies, and some of the items regarding creditor inquiries are often missing. Our simulations, discussed below, address these areas of concern.

Ambiguous Status of Stale Accounts

A primary concern about data quality involves stale accounts. About 29 percent of all accounts in the sample showed positive balances at their most recent reporting, but the report date was more than three months before the sample was drawn. These accounts fell into one of three categories based on their status when last reported: major derogatory (accounts that are 120 days or more in arrears and involve a payment plan, repossession, charge-off, collection action, bankruptcy, or foreclosure), minor delinquency, or paid as agreed. Of all stale accounts with a positive balance at last report, about 15 percent were reported to be major derogatories, 3 percent were minor delinquencies, and 82 percent were paid as agreed.

Analysis of the credit records in the sample suggests that many of these stale accounts, particularly those involving mortgages and installment loans, were likely to have been closed or transferred but were not reported as such. Many were reported by creditors that were no longer reporting data to the agency about any individuals when the sample was drawn, and thus information on these accounts was unlikely to be up to date. The significant fraction of positive-balance stale accounts that were likely closed or transferred implies that some consumers will show higher current balances and a larger number of open accounts than they actually hold.

Because the current status of stale accounts is often unclear, users of consumer credit reports must obtain additional information or make assumptions about the status. In credit-scoring models, such assumptions are inherent in “stale-account rules” that credit modelers typically apply when they calculate an individual’s credit history score. A stale-account rule defines the period for which reporting is considered current and thus identifies stale accounts. The rule also dictates how accounts identified as stale should be treated. In most cases, the rule treats them as closed accounts with zero balances.

To some extent, rules that consider stale accounts closed and paid off may mitigate concerns about stale account information. Another possible mitigating factor is that consumers who review their credit reports for mistakes are likely to catch stale-account errors and to have them corrected. Nevertheless, stale-account rules and consumer action can only partially correct the problem of noncurrent information in credit account records. For example, a rule that is conservative in identifying stale accounts may permit noncurrent information to be used over an extended period, whereas an overly aggressive rule may nullify information that is still current.

Failure to Report Credit Account Information

Some reporters provide incomplete performance information on their accounts, and others fail to report any information about some credit accounts. For example, in the Federal Reserve sample, 2.7 percent of the large creditors reported only credit accounts with payment problems.²³ The failure to report accounts in good standing likely affected the credit evaluations of consumers with such accounts. The way in which credit evaluations are affected depends on the circumstances of an account. For consumers with a low utilization of nonreported accounts, the failure to report may worsen their credit evaluations. For consumers with a high utilization of nonreported accounts, however, the failure to report may result in better credit evaluations than are warranted.

In addition, some creditors report minor delinquent accounts as performing satisfactorily until the accounts become seriously delinquent. Almost 6 percent of the large creditors in the Federal Reserve sample followed this practice. Because the credit histories for consumers who fall behind in their payments to such lenders appear somewhat better in the credit records than they actually are, these consumers may benefit from such underreporting.

Finally, some lenders withhold account information. For example, in 2003, Sallie Mae, the nation’s largest provider of student loans, decided to withhold information on its accounts from two of the three credit-reporting agencies. Clearly, while this policy was in effect, the failure to report information harmed some consumers and benefited others depending on

23. Some lenders, particularly those that specialize in lending to higher-risk individuals (referred to here as subprime lenders), choose to withhold positive performance information about their customers for competitive advantage.

whether the withheld information was favorable or unfavorable.

Unreported Credit Limits

A key factor that credit evaluators consider when they assess the creditworthiness of an individual is credit utilization. If a creditor fails to report a credit limit for an account, credit evaluators must either ignore utilization or use a substitute measure such as the highest-balance level—that is, the largest amount ever owed on the account. Substituting the highest-balance level for the credit limit generally results in a higher estimate of credit utilization because the highest-balance amount is typically lower than the credit limit; the higher estimate leads, in turn, to a higher perceived level of credit risk for affected consumers.

For the June 30, 1999, sample of individuals, proper utilization rates could not be calculated (the highest-balance levels had to be used) for about one-third of the open revolving accounts because the creditors had not reported the credit limits. At that time, about 70 percent of the consumers in the sample had missing credit limits on one or more of their revolving accounts. Circumstances have improved substantially since then because public and private efforts to encourage the reporting of credit limits have resulted in more-consistent reporting. Nevertheless, in the sample drawn as of June 30, 2003, credit limits were missing for about 14 percent of revolving accounts, and the omissions affected about 46 percent of the consumers in the sample. Thus, although the incidence of missing credit limits has fallen substantially, it remains an important data quality issue.

Problems with Collection Agency Accounts, Public Records, and Creditor Inquiries

Data on collection agency accounts, public records, and creditor inquiries are a source of inconsistency, redundancy, and missing information in credit records.

Collection Agency Accounts

Evidence suggests that collection agencies handle claims in an inconsistent manner. Most notably, some collection agencies may report only larger collection amounts to credit-reporting agencies, whereas others

may report claims of any size.²⁴ Inconsistent reporting does not imply inaccuracy of the information that does get reported, but it does imply some arbitrariness in the way individuals with collections are treated. Those whose collection items happen to be reported to the credit-reporting agency will have lower credit history scores than will those whose collection items go unreported. This situation raises the question as to the extent and effect of such arbitrary differences in treatment, particularly for small collection amounts. In addition, anecdotes abound about consumers who have had difficulty resolving disputes over collection items or who have had trouble removing erroneous items from their credit records.

Another potentially important data quality issue for collection agency accounts is duplication of accounts within collection agency records. Duplications can occur, for example, when a collection company transfers a claim to another collection company. Duplications can also occur when a debt in collection is satisfied but the paid collection is recorded as a separate line item by the collection agency. Analysis of the collection agency accounts in the latest Federal Reserve sample suggests that about 5 percent of collection items are likely duplications resulting from such transfers or payouts.

Credit evaluators also have some concern about the appropriateness of using medical collection items in credit evaluations because these items (1) are relatively more likely to be in dispute, (2) are inconsistently reported, (3) may be of questionable value in predicting future payment performance, or (4) raise issues of rights to privacy and fair treatment of the disabled or ill. The last concern recently received special attention with the inclusion of provisions in the FACT Act that address medical-related collections. One provision requires the credit-reporting agencies to restrict information that identifies the provider or the nature of medical services, products, or devices unless the agencies have a consumer's affirmative consent. In the future, the agencies may be able to meet this requirement by using a code, with the name of the creditor suppressed, to distinguish medical-related collections from other collections. Because the coding system is prospective, however, even if implemented today, years may pass before all the collection items in the agency files have this code. In the interim, if the name of the creditor is suppressed, distinguishing medical collection items

24. One indication of the inconsistent reporting of collection items is the wide dispersion across states in the ratio of small collection items to all collection agency accounts. The percentage ranges from 30 percent to 60 percent.

will depend on the ability of the credit-reporting agencies to mechanically code historical data. If such coding is done imperfectly, it may adversely affect consumers who deal with creditors that want to discount collection items involving medical incidents. (As of September 2004, at least one of the agencies had developed a system that suppresses the name of the creditor and uses a code to distinguish medical-related collections.)

Public Records

Public records suffer from similar consistency and duplication problems that affect collection items. In particular, a single episode can result in one or more public record items depending on how it is recorded. For example, tax liens can be recorded on a consolidated basis or treated as separate items. Similarly, amendments to a public record filing, such as a bankruptcy or a foreclosure, can be treated as updates, which result in no change in the number of items, or as new filings.

In addition, evidence suggests that the credit-reporting agencies inconsistently gather information on lawsuits that the courts have not yet acted on, in part because some agency officials believe that the mere filing of a lawsuit does not necessarily relate to future credit performance. For the most part, such lawsuits are missing from the public records. However, for idiosyncratic reasons, some lawsuits have been reported in nonrandom ways. Specifically, 80 percent of the lawsuits in the Federal Reserve sample came from only two states, an indication that residents of these states may be at a disadvantage in credit evaluations.

About one-fourth of non-bankruptcy-related public records reflect dismissals. In such cases, the courts seem to have determined that the individuals are not legally liable. Such information may be of questionable value for credit evaluations.

Creditor Inquiries

Although credit evaluators use information on creditor inquiries to predict future loan performance, the value of this information is limited in an important way. Ideally, credit evaluators would use such information to distinguish the consumers who are seeking multiple loans to greatly expand their borrowing from the consumers who are shopping for the best terms for a single loan. However, the information that evaluators need to make this distinction—that is, a

code that identifies the type of credit sought from the inquiring lender—is generally not available in inquiry records (it is missing from 99 percent of the inquiries in the Federal Reserve sample). Consequently, credit evaluators must use less reliable rules, potentially harming consumers who are simply shopping for a single loan by failing to distinguish them sufficiently from consumers who are seeking an excessive amount of credit.

DESIGN OF THE SIMULATIONS

We designed a series of simulations to estimate the potential effects of the data quality issues identified in the preceding section. Each simulation identified a set of “data problems” or potential problems, applied a plausible “correction” to each problem, and used an approximation of the proprietary credit-risk model to evaluate the effect of the correction on the credit history scores of individuals who had the problem in their credit records.²⁵ We estimated how many consumers each data problem affected; and for those who were affected, we estimated how many would see a decrease or an increase in their scores and by how much when the problem was corrected.

Selecting Factors in the Approximated Model

The first step in setting up the simulations was selecting the factors to be used in the approximated credit-scoring model. The approximated model used seventy-three factors, including the number of credit accounts of different types and the various characterizations of payment history patterns, such as the number of accounts with all payments made on time, in various stages of delinquency, or with major derogatory status. Also included were measures of outstanding balances, credit limits on revolving accounts, ages of credit accounts, variables derived from collection agency accounts and public records, and account inquiry information. Our discussions with credit evaluators suggested that most credit history models are based on a smaller number of factors than were included here. However, most of the “additional” variables in our model were decompositions or interactions that involved more general factors and were unlikely to lead to significant distortions in our representations of the effects of data quality issues.

25. We use the terms “data problem” and “correction” in their broadest sense. For example, “data problem” may mean an actual problem or only a potential problem. Similarly, “correction” may mean a solution to a problem or simply a “best guess” at a solution.

2. Share of individuals with selected factors used in credit evaluation, distributed by type of account

Percent except as noted

Factor used in credit evaluation	Factor used in credit evaluation	Type of account			
		Revolving	Installment	Mortgage	Total
<i>Number of credit</i>					
No account	<i>Number of credit accounts</i>				
1	<i>30 days past due in past</i>				
2	<i>12 months</i>				
3-5	0	n.a.	n.a.	n.a.	75
6-8	1	n.a.	n.a.	n.a.	13
9 or more	2	n.a.	n.a.	n.a.	5
Total	3 or more	n.a.	n.a.	n.a.	7
	Total	n.a.	n.a.	n.a.	100
<i>Number of open cr accounts paid as</i>					
0	<i>Number of credit accounts</i>				
1	<i>60 days past due in past</i>				
2	<i>12 months</i>				
3-5	0	n.a.	n.a.	n.a.	82
6-8	1	n.a.	n.a.	n.a.	10
9 or more	2	n.a.	n.a.	n.a.	4
Total	3 or more	n.a.	n.a.	n.a.	4
	Total	n.a.	n.a.	n.a.	100
<i>Number of credit opened in most-recent 12 months¹</i>					
0	<i>Number of credit accounts</i>				
1	<i>90 days past due in past</i>				
2 or more	<i>12 months</i>				
Total	0	n.a.	n.a.	n.a.	86
	1	n.a.	n.a.	n.a.	8
	2	n.a.	n.a.	n.a.	3
	3 or more	n.a.	n.a.	n.a.	3
	Total	n.a.	n.a.	n.a.	100
<i>Years since most-r credit account opened</i>					
0	<i>Number of credit accounts</i>				
Less than 1	<i>more than 90 days past due</i>				
1-2	0	n.a.	n.a.	n.a.	68
3-4	1	n.a.	n.a.	n.a.	11
5 or more	2	n.a.	n.a.	n.a.	6
Total	3 or more	n.a.	n.a.	n.a.	15
	Total	n.a.	n.a.	n.a.	100
<i>Age of oldest credit (years)²</i>					
No oldest account	<i>Worst delinquency ever on credit account (number of days delinquent)</i>				
Less than 1	0	n.a.	n.a.	n.a.	51
1-4	30	n.a.	n.a.	n.a.	12
5-9	60	n.a.	n.a.	n.a.	5
10 or more	90	n.a.	n.a.	n.a.	2
Total	120	n.a.	n.a.	n.a.	4
	More than 120	n.a.	n.a.	n.a.	26
	Total	n.a.	n.a.	n.a.	100
<i>Amount owed on nonmortgage credit (dollars)</i>					
0	<i>Balance owed on collection accounts (dollars)</i>				
1-499	No collection account or zero balance owed	...	...	...	73
500-999	1-99	...	...	...	2
1,000-4,999	100-499	...	...	...	9
5,000-9,999	500-999	...	...	...	5
10,000 or more	1,000 or more	...	...	...	11
Total	Total	...	...	...	100
<i>Utilization rate for accounts (percent)</i>					
No account or not calculable	<i>Number of public records</i>				
0	0	...	...	...	86
1-24	1	...	...	...	9
25-49	2 or more	...	...	...	5
50 or more	Total	...	...	...	100
Total					
<i>Share of individuals credit accounts never delinquent</i>					
0	<i>Number of creditor inquiries in past 6 months</i>				
1-20	0	...	...	...	55
21-60	1	...	...	...	20
61-90	2	...	...	...	11
91 or more	3	...	...	...	6
Total	4 or more	...	...	...	8
	Total	...	...	...	100

NOTE. Data include only individuals with at least one credit account (of any type) and a credit history score.

1. Data for revolving accounts include only bank-issued credit cards.
2. Data for installment accounts include only bank-issued installment loans.
3. Utilization rate is the proportion of available credit in use (outstanding balance divided by the credit limit—that is, the maximum amount an individual

is authorized to borrow). The rate cannot be calculated in all cases because of unreported information on credit limit, highest balance, or outstanding balance.

- ... Not applicable.
- n.a. Not available.

We report many of the factors used in our model and show the distribution of individuals in the sample across each factor (table 2). For example, more than 60 percent of the individuals in the sample who had a record of a credit account had information on nine or more accounts, and more than half the individuals had opened at least one new account within twelve months of the date the sample was drawn. The patterns show that payment performance varies greatly among individuals: Although about two-thirds of individuals had never been more than ninety days past due on a credit account, 15 percent had been this late on three or more accounts. In addition, nearly 15 percent had a record of at least one bankruptcy, tax lien, or other monetary-related public action, each of which weighs heavily in credit evaluations.

Estimating the Approximated Model

To estimate our approximation of the proprietary credit-scoring model, we used standard statistical regression techniques to fit the actual proprietary credit-risk score against the selected credit factors for the individuals in the sample data. Although credit modelers typically break factors into ranges, because we did not know the break points that had been selected, we approximated the process with linear splines.²⁶ For the estimation, the sample included only individuals with proprietary credit-risk scores who had not filed for bankruptcy. Our simulations were also restricted to this sample.²⁷

We estimated the regression equation separately for three subpopulations. The first group consisted of individuals with one or more major derogatory credit accounts in their credit records. Both the second and third groups consisted of individuals who had no major derogatory accounts, but individuals in the second group had no more than two credit accounts whereas those in the third group had more than two credit accounts. We conducted the analysis in this way because allowing the estimated coefficients to

26. The use of linear approximations rather than ranges is likely to mean that our simulations implied more small but consistent changes in credit history scores when factors were altered than would the “true” model, which divides consumers into two groups: those whose scores did not change because they stayed within the same range and those whose scores changed more substantially because they moved to a different range.

27. Although individuals who had filed for bankruptcy or did not have a proprietary credit-risk score were excluded from our analysis, these individuals may also have been affected by data quality problems. However, because they had not been scored or they had filed for bankruptcy, they were likely subject to a different type of credit review process, one that may have provided greater opportunities for the loan underwriter to identify and address data quality problems.

differ across population subgroups provided a noticeably better fit. The approach was also consistent with the common industry practice of using different “scorecards” for different subpopulations. The R^2 (a statistic characterizing how well a model fits the data) for each of the three subpopulation regressions was about 0.85, and the combined R^2 for the full population was about 0.94.

Proprietary considerations constrain our ability to report details of the regression equation specification or the coefficient estimates. However, a few variables in the estimated credit-scoring model were statistically insignificant and sometimes exhibited an unexpected relationship to the credit history score. As a consequence, as will be seen below, simulations of the effects of changes in an individual’s credit record led in a few instances to anomalous outcomes in the sense that some scores moved in unexpected directions when changes in the individual’s credit record were simulated.

Conducting the Simulations

As noted, the simulations identified problems in the data and applied hypothetical corrections to them. Only in the case of missing credit limits, however, could we identify the problem unambiguously. In other cases—specifically, stale accounts and the data quality issues associated with collections, public records, and inquiries—we could determine only that the information was *likely* inaccurate, incomplete, or of questionable value.²⁸ Finally, in other situations, a data problem was unobservable, such as when accounts were unreported or inconsistently reported. In these situations, we could identify only the potential effect on credit history scores of correcting the problem but not the proportion of people affected.

We conducted fifteen simulations: three that addressed issues related to stale credit accounts, four that pertained to nonreported credit account information, and eight that addressed data quality issues for collection agency accounts, public record items, and creditor inquiries.

Stale Accounts Last Reported as Paid as Agreed or as Minor Delinquencies

Recognizing the prevalence of stale accounts in credit records, most credit-scoring modelers apply stale-

28. In the case of stale accounts, the information was clearly outdated. In the case of inquiries, the information was incomplete in that we could not determine whether the inquiries were associated with shopping for a single loan.

account rules to such accounts when they develop credit evaluation models. For credit accounts that have never been in major derogatory status (paid-as-agreed accounts or accounts with only minor delinquencies recorded), the rules typically retain the historic information on payment performance but dictate that certain accounts that have gone unreported for an extended period no longer have balances outstanding. Any balances shown at last report for these accounts are reset to zero.

In reverse-engineering the factors used in this analysis, we discovered that the credit-reporting agency had imposed a one-year stale-account rule when it created most factors related to paid-as-agreed accounts and to accounts with only minor delinquencies. Our simulation examined the effects on these accounts of a more-aggressive stale-account rule, one that redefined stale accounts on the basis of a three-month period for current reporting.²⁹

Stale Accounts with Major Derogatories

Some stale accounts were last reported in major derogatory status. Here the payment status was more likely to have remained the same since the last report than it was in the case of stale accounts that were paid as agreed or showed only minor delinquencies at last report. Many seriously delinquent accounts can remain in that state for an extended period with no change in status (and thus the account information need not be updated). However, in several situations, the reported account status is likely to be no longer accurate, such as when a consumer has taken out a new mortgage after the date on which the stale major derogatory was last reported. Generally, a mortgage lender will not extend a new loan until a consumer pays off (or otherwise addresses) all major derogatories. Another situation in which the reported account status is likely to be inaccurate is when the account creditor no longer reports about any individuals. In this case, the account has probably been paid off or transferred.

We evaluated the effect of non-updating of credit account information in these situations by treating as paid off all stale major derogatories for which (1) the consumer had taken out a new mortgage after the date on which the major derogatory was last reported

or (2) the creditor for the derogatory account had not reported information on any consumer within three months of the date on which the sample was drawn. The credit-reporting agency had imposed a one-year stale-account rule when it created factors related to major derogatory accounts. The rule implied that paying off a major derogatory account that had not been reported within a year generally would have no effect on an individual's credit history score. Thus, we again restricted our analysis of the effect of stale accounts to those that had last been reported three to twelve months before the date on which the sample was drawn.

Failure of Some Subprime Creditors to Report Accounts

As a potential source of data inaccuracy, the failure of some subprime creditors (lenders that specialize in loans for high-risk individuals) to report accounts differs from the others studied here in that non-reporting is by definition unobservable. Consequently, the task for researchers is conceptually more difficult, and simulations cannot address the incidence of such nonreporting. To simulate the potential effect of such creditor behavior, we chose a random, never-delinquent mortgage, installment, or revolving account at a subprime lender for each individual with such an account and rescored the individual as if the account had not been reported. We defined subprime lenders as those that were reporting credit accounts as of the date the sample was drawn and for which more than one-half of their customers in the sample had credit history scores in the high-risk range (a score below 600).

Failure of the Largest Student Loan Creditor to Report Any Accounts

As noted above, in 2003 Sallie Mae stopped reporting information on its accounts to two of the three largest credit-reporting agencies. Moreover, Sallie Mae asked that the agencies suppress all historic information on the accounts it had previously reported. By the time the Federal Reserve sample was drawn, Sallie Mae had reversed its initial decision. Our sample omits information that would allow us to identify Sallie Mae specifically. Thus, to approximate the potential effect of Sallie Mae's original decision, we deleted information on the loans of random student-loan lenders—representing approximately the same number of student loans that Sallie

29. Analysis of the patterns of verification showed that the vast majority of open accounts were verified by the reporter every month or two. Thus, in choosing a three-month rule, we simulated the effect of a maximally aggressive stale-account rule on the likely inaccuracy associated with the account information. We had no obvious way of simulating the effect of lengthening the time period.

Mae stopped reporting—from the credit records in the Federal Reserve sample, and we rescored the affected individuals.

Failure of Some Creditors to Report Minor Delinquencies

Our review of the sample indicates that a small percentage of lenders fail to report that paid-as-agreed accounts have become minor delinquencies. Rather, the lenders report the accounts as paid as agreed until the accounts become major derogatories. To simulate the potential effects of unreported minor delinquencies, for each individual we randomly selected a currently reported account that was not in major derogatory status, was associated with a lender that did report minor delinquencies for each individual, and had been thirty or sixty days delinquent at least once. We assigned “paying as agreed” performance status to each thirty- and sixty-day delinquency in the selected account’s performance record. This adjustment replicates what the credit record would show for a lender that reported thirty- and sixty-day minor delinquencies to be paid as agreed.

Failure of Some Creditors to Report Credit Limits on Revolving Accounts

As noted, about 14 percent of revolving credit accounts were reported without information about credit limits, affecting roughly 46 percent of the individuals in the Federal Reserve sample. Therefore, credit evaluators must use other means to derive credit utilization rates for these individuals. The most common approach (and the one that model developers customarily use for credit-risk factors) is to substitute the highest balance for the missing credit limit; the typical result is higher calculated utilization rates than if the credit limits had been reported.

We simulated the effects of the nonreporting of credit limits on individuals by creating an estimated credit limit for each revolving account without a reported limit. Because information on the true credit limit in these cases was missing, the simulation in effect compared our method of calculating credit utilization rates with that of the credit-reporting agency. The primary difference between the two estimation procedures is that our approach is statistically unbiased, whereas the agency’s method, which relies on the highest-balance amount, tends to be biased upward. That is, our estimates reflect the “best guess” for the missing credit limit based on other information in the individual’s credit record. Specifi-

cally, we used samples of accounts of individuals with reported credit limits to estimate a regression model that predicted the credit limits for revolving accounts with missing limits.³⁰

Duplications in Collection Agency Accounts

A review of the sample credit records suggests that some collection agency accounts may be duplicated. Duplication can occur because of changed account numbers or transfers of accounts from one collection agency to another. To address the potential effects of this problem, we conducted simulations that consolidated likely duplicated collection account records into single items. We identified simulated duplicates in two ways. One procedure was to match the collection amount and the identity of the creditor when one account was reported paid and the other unpaid. The second procedure was to identify likely account transfers that were not reported as such to the credit-reporting agencies.

Additional duplicate collection agency accounts likely exist in the data but are difficult to identify. For example, accounts that match on collection amount and identity of the original creditor but that are reported by a single agency with reporting dates that are close in time may be duplicates, but they may just as likely result from repeated missed payments of the same amount. Accounts that match on identity of the original creditor and are spaced apart in time but do not match on amount could indicate a new report filed after a partial payment was received, in which case they would involve duplication. Alternatively, they could reflect separate incidents of missed payments with the same creditor.

Inconsistent Reporting of Small Collection Agency Accounts

Analysis of collection accounts reveals that many are for very small amounts that may be inconsistently reported. Recognizing this possibility, some credit evaluators choose to exclude small collection accounts from credit evaluations. To test the effect of inconsistently reported small collection items on

30. Independent factors used in the estimation included outstanding balance and highest-balance level, the age and type of account, the type of lender, balances and limits on other accounts, and payment performance information. The resulting distribution of estimated credit limits and utilization for accounts with imputed limits was virtually identical to the distribution of accounts with reported limits within the population, an indication that missing limits are primarily a function of the lender and are almost always unrelated to the characteristics of the account.

credit history scores, we removed all collection records involving items under \$100 from the credit records.

Medical Collection Items

Some credit evaluators report that they remove collection accounts related to medical services from credit evaluations because such accounts often involve disputes with insurance companies over liability for the accounts or because the accounts may not indicate future performance on loans. Unfortunately, evaluators must use manual overrides based on the creditors' identities to remove medical collection accounts because the credit record data lack a code identifying claims associated with medical services. The absence of a code means that this process cannot be used in automated calculations of credit history scores. To test the potential effect of including medical collection items in the calculation of credit history scores, we developed a medical collection code based on an inspection of the creditor name, and we used the code to identify medical collection accounts to drop from the credit history score calculation (as noted earlier, as of this writing, at least one of the agencies had developed such a code, potentially reducing the relevance of this simulation).

Potentially Misassigned Collection Agency Accounts

Most (72 percent) of the individuals in the sample with a non-credit-related collection agency account also had a credit-related major derogatory. About 45 percent of those individuals with information reported by a single collection agency had no credit-related major derogatories. In contrast, only about 15 percent of those with information reported by more than one collection agency had no credit-related major derogatories. These patterns suggest that misassigned collection agency accounts may be more common among those with information reported by a single collection agency. We simulated the effects of correcting such misassigned collections by dropping the collection accounts of individuals who had information reported by one collection agency but had no credit-related major derogatories.

Duplications in Public Records

As with our analysis of collection agency accounts, our review of the sample public record reports

suggests that some records may be duplicated. To address the potential effects of this problem, we conducted simulations that removed likely duplicates of public record items. We identified duplicates by matches on the recording date, amount owed, and creditor. In many instances, the duplicates involved the original filing of a judgment or lien, which was followed by a record of a paid judgment or lien with all information identical to that in the first record. In other instances, second or third filings may have ended up as duplicates with the same (or almost identical) information.

Inconsistent Reporting of Lawsuits and Dismissed Items in Public Records

As noted earlier, our analysis of credit record files in the Federal Reserve sample suggests that lawsuits are inconsistently included in the credit-reporting agency files. An additional issue concerns the inclusion in the public records of dismissed liens, judgments, or suits, which may be of questionable value for predicting credit performance. To simulate the potential effects of including these items in the calculation of credit history scores, we removed all lawsuits and dismissals from the credit records of individuals with such items.

Failure to Consolidate Multiple Inquiries for the Same Loan

Analysts have cautioned that simple counts of inquiries in scoring models may unfairly penalize consumers who shop for credit. However, the information needed to help distinguish consumers shopping to obtain a single loan from those seeking to obtain multiple loans is generally not available in credit records because of incomplete reporting of the type of inquiry.

To simulate the potential magnitude of the effect of incomplete reporting of the type of inquiry, we conducted two experiments. First, we identified all individuals in the sample who had taken out a mortgage or an auto loan in the two years before the sample was drawn. For each loan type, we consolidated into a single inquiry the multiple inquiries that had occurred in the two-month period preceding the date on which the loan was opened (if any non-auto or non-mortgage loans were also taken out during this period, we did not consolidate any inquiries). The second simulation was somewhat broader. We divided all inquiries into three groups based on the type of inquirer as a proxy for the likelihood that

the consumer was shopping for a single loan or potentially “bulking up on credit.” The first group represented inquiries that were unlikely to be credit-related, including inquiries from insurance companies, utilities, and collection agencies. The second group involved inquiries likely related to the purchase of a single large item, such as inquiries from auto companies or real estate firms. We put all other inquiries in the third group. Inquiries from the first group were dropped in the simulation because they did not appear to be credit related. For the second group, we consolidated all inquiries within a two-week period into a single inquiry. Only inquiries from the third group were left unchanged.

Analyzing the Populations of Interest

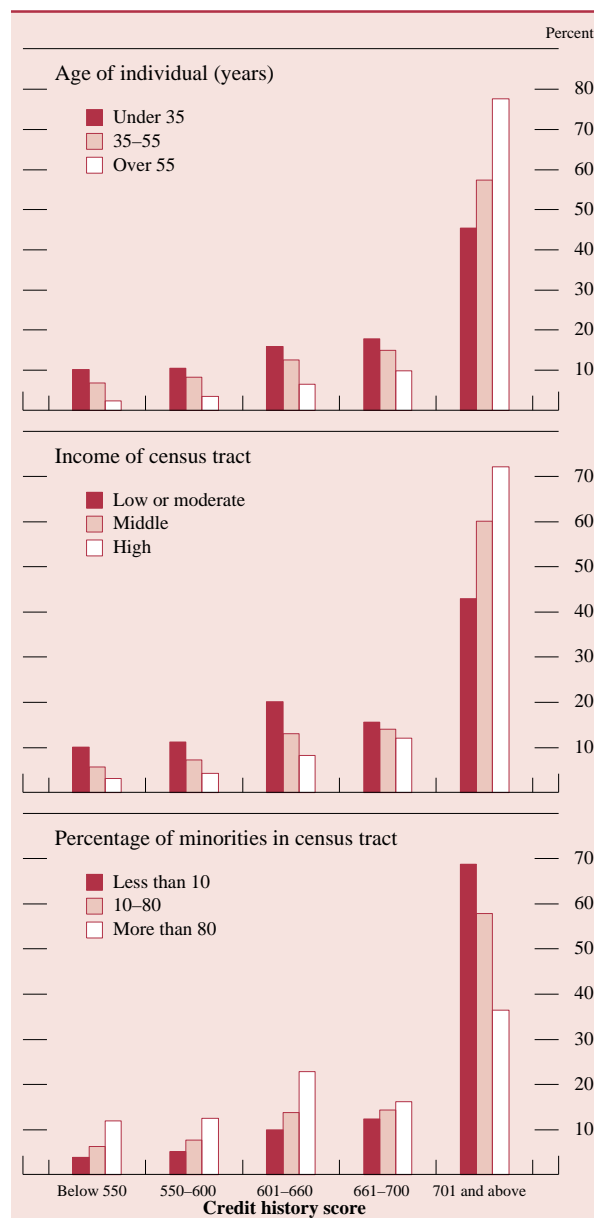
Each of the data quality issues that we focus on may have different implications for different individuals depending on the individuals’ credit characteristics. For example, the effect of a missing credit limit will be different for individuals who have many open revolving accounts than for those who have few. Therefore, we also examined the effect of these data quality issues for three subpopulations of interest. Because data quality problems are less likely to affect the access to credit of individuals with relatively high credit history scores, we divided the analysis population (the same one used to estimate the approximated model) into categories based on credit history score. We also categorized the analysis population by depth of credit file and by selected demographic characteristics.

For the analysis by credit history scores, we sorted individuals into one of three risk groups based on their proprietary credit-risk scores. The first group included individuals whose scores were 661 or above (74 percent of the sample population), the second group included individuals with scores between 600 and 660 (13 percent of the sample), and the third group included individuals whose scores were below 600 (13 percent of the sample).³¹

31. Individuals with credit scores above 660 have scores sufficiently high that they are likely to qualify for the lowest interest rates available on loans, and individuals with scores below 600 have scores sufficiently low that they are likely to be denied credit or to pay substantially higher rates than those charged to better-qualified borrowers. Individuals in the middle category have scores that place them at the margin.

The credit history score ranges used here are not immutable; in practice, the bounds of these ranges vary somewhat by loan product and by the appetite for risk of individual market participants. Moreover, credit history is only one factor considered in credit underwriting, although an important one, and so a low credit history score may be offset by, for example, a low debt-to-income ratio, a significant down payment, collateral, or potential for strong future earnings.

2. Distribution of individuals, by credit history score and by selected demographic characteristics



NOTE. See note to chart 1. Income categories are defined as follows: *low or moderate*, less than 80 percent of the median family income of individual’s metropolitan statistical area (MSA) or of nonmetropolitan portion of individual’s state; *middle*, 80–119 percent of the median family income of individual’s MSA or of nonmetropolitan portion of individual’s state; *high*, 120 percent or more of the median family income of individual’s MSA or of nonmetropolitan portion of individual’s state.

For the analysis by depth of credit file, we sorted individuals with records of credit accounts into two groups based on the number of credit accounts in their credit records. One group consisted of individuals with “thin files”—that is, files with fewer than four credit accounts. The second group consisted of all other individuals. Individuals with thin files, who

accounted for about 19 percent of the sample, are an important segment of the population to examine because their credit history scores may exhibit relatively greater sensitivity to data problems. A data problem affecting a particular account may be more likely to have a substantial effect on the credit history score of an individual with a thin file because of a lack of information from other accounts that could dilute the effect of the problem.

For the other analyses, we investigated whether different patterns emerge when individuals are grouped by age, relative income of census tract of residence, and percentage of minorities in census tract of residence. Such segmentation allows us to determine whether issues of data accuracy and completeness likely affect various subgroups of the population in different ways. For example, residents of higher-income census tracts may, on average, have more revolving accounts than residents of lower-income areas and therefore may face a greater probability of encountering a missing credit limit. We report the distribution of proprietary credit-risk scores

for these various subgroups (chart 2).³² In general, younger individuals, those who live in lower-income areas, and those who live in areas with high minority populations have lower scores.

RESULTS

First, we report the proportion of individuals who are affected by a simulated change in (correction to) the credit records—that is, the proportion subject to the data quality issue in question (table 3). Second, we report the proportion among those affected by the simulated change in credit records for which the net effect on approximated credit history scores was zero. Third, we report the proportions of individuals among those affected by the simulated change for which approximated credit history scores changed

32. Scores in chart 2 are somewhat higher than scores for individuals in the simulation samples, which exclude individuals who have had bankruptcies.

3. Estimated effects of data “corrections” on the credit history scores of individuals, by data problem corrected

Percent except as noted

Data problem corrected	Individuals affected	Distribution of individuals affected					Total	Memo	
		Effect on credit history score						Mean change in points	
		No change	Decrease		Increase			Individuals with decrease in score	Individuals with increase in score
			1–9 points	10 or more points	1–9 points	10 or more points			
<i>Involving credit accounts</i>									
Failure to close a									
Paid-as-agreed account	12.9	10.9	27.0	8.1	48.7	5.2	100.0	-8.1	4.4
Minor delinquent account	1.3	4.5	20.0	17.8	43.1	14.5	100.0	-12.6	8.6
Major derogatory account	4.7	82.3	9.2	.3	8.2	.0	100.0	-1.9	1.2
Failure of a subprime lender to report									
a paid-as-agreed account	n.c.	28.5	41.0	8.9	17.9	3.7	100.0	-6.0	6.2
Failure of largest student loan									
creditor to report	3.5	16.1	45.0	13.1	21.5	4.4	100.0	-7.0	7.5
Failure to report a									
Minor delinquency	n.c.	15.1	39.3	20.8	22.4	2.4	100.0	-11.0	4.0
Credit limit	33.0	31.7	1.7	.0	53.3	13.3	100.0	-1.4	6.1
<i>Involving collection agency accounts</i>									
Failure to eliminate duplicate									
collection agency accounts	1.2	6.8	1.1	.0	67.4	24.7	100.0	-1.4	8.5
Reporting of									
Collection agency accounts									
under \$100	11.1	41.2	7.0	1.2	41.7	8.9	100.0	-4.3	5.8
Medical collection accounts	15.5	11.8	5.4	1.5	49.6	31.6	100.0	-5.9	11.2
Potentially misassigned collection									
accounts	8.2	12.8	9.0	3.4	42.8	31.9	100.0	-6.9	13.4
<i>Involving public records</i>									
Reporting of duplicate public records	.4	38.6	1.9	.0	59.4	.1	100.0	-1.9	1.3
Inclusion of lawsuits and dismissals	1.1	18.5	3.8	1.0	53.1	23.6	100.0	-5.9	9.1
<i>Involving creditor inquiries</i>									
Failure to consolidate									
Multiple inquiries for auto and									
mortgage loans	3.7	16.8	8.3	.5	73.8	.7	100.0	-2.9	2.3
Other multiple inquiries	14.6	5.2	4.9	.1	85.4	4.4	100.0	-2.3	4.2

NOTE. The table reports the effect of “correcting” a data problem. Individuals whose scores increase because of a correction would be better off if the problem were corrected.

n.c. Not calculable.

materially—that is, increased or decreased 10 or more points. These calculations provide insight into the proportion of consumers who may or may not face a change in credit terms (either a higher or a lower interest rate) or who may be unable to gain access to credit because of the particular data problem. Also, to provide another basis for determining how much variation in credit history scores may occur when simulated corrections are made to individuals' credit records, we present the overall mean change in credit history scores for the individuals who were materially affected. Because the hypothesized correction may increase or decrease an individual's credit history score depending on the nature of the problem and the composition of the individual's credit record, the mean change for individuals with a decrease in score and the mean change for those with an increase in score are shown separately.

For each simulation, the overall effect of a simulated change on an individual can be either positive or negative. Some of the effect is undoubtedly due to imprecision in our approximation of the credit-scoring model or to consumers' being shifted from one "scorecard" to another. However, we believe the results mainly reflect the complexity of interactions among the various factors that produce a credit history score. For example, a failure to report a paid-as-agreed account as closed can help individuals with few active and paid-as-agreed credit accounts but can hurt individuals with a substantial number of accounts that have high balances and utilization rates.

Effects of Stale Accounts

The first group of simulations presented in the table involved hypothetical corrections to selected credit account records. The first three of these pertained to the use of a more aggressive stale-account rule that designated accounts as stale after three months of nonreporting and treated the accounts as being closed and having a zero balance. Several conclusions emerged from these simulations. On the one hand, a significant proportion of consumers appeared to be subject to stale credit account issues. Almost one-fifth of the individuals in the Federal Reserve sample had at least one stale credit account as defined by the assumptions of the first three simulations. Further, 21 percent of the individuals with stale major derogatories (percentage not shown in table) had at least one account that met the conditions of the third simulation and thus had potentially been paid off.

On the other hand, the application of the more aggressive stale-account rule appeared to have only

a modest effect on the credit history scores of these individuals. Our simulations suggest that more than 80 percent of the individuals with stale major derogatories would have shown no change in score if they had paid off the account the month after the date on which the lender last reported it and the lender had reported the payoff to the credit-reporting agency. The effect of paying off accounts was somewhat larger for paid-as-agreed accounts and for those with minor delinquencies, but even here most consumers showed changes of fewer than 10 points. One likely explanation for the relatively minor effect of the corrections on individuals is the large number of credit accounts in the typical consumer's file. For example, consumers with a stale paid-as-agreed account had, on average, almost sixteen credit accounts, and 90 percent of these consumers had at least five.

Many of the credit-risk factors reflect "extreme" values such as the age of the oldest account or the number of months since the most-recent delinquency. These factors will change as the result of a correction only if the affected account is the "marginal" account—for example, the oldest or the most recently delinquent. Moreover, although factors reflecting sums, such as total balances, will be sensitive to changes in any account, the effect of the change will be reduced if many other accounts contribute to the factor. Another explanation for the relatively minor effects of the corrections for stale accounts probably lies in the rules used to calculate the factors employed by credit modelers. For example, modelers appear to place little weight on outstanding balances for major derogatory accounts, perhaps recognizing the inconsistency in the reporting of account payoffs. Thus, when payoffs are recorded, the effect on scores is minimal.

Effects of Unreported Credit Account Information

We conducted an additional four simulations for data problems in credit accounts. The simulations addressed the nonreporting of certain categories of accounts (paid-as-agreed accounts of a subprime lender and accounts of the largest student loan creditor) and of certain types of information (minor delinquencies and credit limits).

We could not determine the incidence of subprime creditors' failure to report paid-as-agreed credit accounts. By our estimates, Sallie Mae's failure to report loans affected less than 4 percent of individuals. Nonreporting of these types of accounts appeared

4. Estimated effects of data “corrections” on the credit history scores of individuals, by data problem corrected, for selected credit history score ranges

Percent except as noted

Data problem corrected	Individuals affected	Distribution of individuals affected					Total	Memo	
		Effect on credit history score						Mean change in points	
		No change	Decrease		Increase			Individuals with decrease in score	Individuals with increase in score
		1-9 points	10 or more points	1-9 points	10 or more points				
Individuals with credit history scores above 660									
<i>Involving credit accounts</i>									
Failure to close a									
Paid-as-agreed account	13.6	11.3	22.0	4.7	55.8	6.2	100.0	-6.1	4.5
Minor delinquent account	.2	3.1	19.2	52.9	21.7	3.1	100.0	-20.2	5.0
Major derogatory account	1.2	89.1	6.1	.2	4.6	.0	100.0	-1.8	1.0
Failure of a subprime lender to report a paid-as-agreed account									
Failure of largest student loan creditor to report	n.c.	45.5	30.1	2.8	20.3	1.3	100.0	-4.3	3.0
Failure to report a									
Minor delinquency	n.c.	19.6	45.7	20.0	14.2	.6	100.0	-9.3	3.0
Credit limit	35.8	34.8	1.4	.0	54.1	9.7	100.0	-1.1	5.1
<i>Involving collection agency accounts</i>									
Failure to eliminate duplicate collection agency accounts									
Reporting of	.1	11.7	.4	.0	81.4	6.6	100.0	-1.0	4.6
Collection agency accounts under \$100									
Medical collection accounts	3.6	21.8	9.3	2.7	42.8	23.4	100.0	-5.8	10.6
Potentially misassigned collection accounts	6.5	5.2	8.0	2.9	35.7	48.3	100.0	-6.8	16.6
Potentially misassigned collection accounts	5.4	4.7	11.0	4.4	31.4	48.6	100.0	-1.6	6.4
<i>Involving public records</i>									
Reporting of duplicate public records	.2	39.1	2.3	.0	58.6	.0	100.0	-1.0	1.1
Inclusion of lawsuits and dismissals	.7	19.2	5.0	1.7	45.5	28.7	100.0	-7.0	10.8
<i>Involving creditor inquiries</i>									
Failure to consolidate									
Multiple inquiries for auto and mortgage loans	3.4	10.9	3.8	.0	84.7	.7	100.0	-1.6	2.3
Other multiple inquiries	12.2	3.1	1.4	.0	94.0	1.5	100.0	-1.4	3.6
Individuals with credit history scores between 600 and 660									
<i>Involving credit accounts</i>									
Failure to close a									
Paid-as-agreed account	12.1	11.0	49.4	13.0	25.4	1.3	100.0	-6.4	3.3
Minor delinquent account	2.6	4.0	27.2	22.6	41.7	4.6	100.0	-11.9	4.9
Major derogatory account	10.2	87.9	6.4	.1	5.7	.0	100.0	-1.7	1.3
Failure of a subprime lender to report a paid-as-agreed account									
Failure of largest student loan creditor to report	n.c.	22.2	48.6	6.4	19.4	3.5	100.0	-4.2	4.9
Failure to report a									
Minor delinquency	3.8	8.1	33.7	17.6	33.0	7.6	100.0	-9.5	6.0
Credit limit	n.c.	11.0	33.1	21.5	31.2	3.2	100.0	-11.7	3.7
Credit limit	28.4	14.4	2.3	.0	57.2	26.1	100.0	-1.8	7.8
<i>Involving collection agency accounts</i>									
Failure to eliminate duplicate collection agency accounts									
Reporting of	3.0	8.6	.8	.0	80.7	9.9	100.0	-1.0	5.3
Collection agency accounts under \$100									
Medical collection accounts	28.1	43.6	5.7	1.2	42.7	6.9	100.0	-5.1	4.4
Potentially misassigned collection accounts	38.8	11.1	4.4	1.7	56.5	26.4	100.0	-7.2	9.2
Potentially misassigned collection accounts	11.8	18.1	9.7	6.9	48.1	17.2	100.0	-9.8	9.6
<i>Involving public records</i>									
Reporting of duplicate public records	.7	44.3	1.0	.0	54.7	.0	100.0	-1.0	1.1
Inclusion of lawsuits and dismissals	2.1	20.8	2.2	.2	62.2	14.7	100.0	-4.2	6.4
<i>Involving creditor inquiries</i>									
Failure to consolidate									
Multiple inquiries for auto and mortgage loans	5.0	32.7	15.1	.1	51.6	.6	100.0	-1.9	2.0
Other multiple inquiries	17.0	10.0	7.8	.0	80.9	1.3	100.0	-1.5	3.9

4.—Continued

Data problem corrected	Individuals affected	Distribution of individuals affected					Total	Memo	
		Effect on credit history score						Mean change in points	
		No change	Decrease		Increase			Individuals with decrease in score	Individuals with increase in score
			1–9 points	10 or more points	1–9 points	10 or more points			
Individuals with credit history scores below 600									
<i>Involving credit accounts</i>									
Failure to close a									
Paid-as-agreed account	9.1	7.0	46.0	35.8	10.4	.8	100.0	-16.8	3.3
Minor delinquent account	7.1	5.0	17.3	9.9	47.4	20.4	100.0	-9.7	9.8
Major derogatory account	22.9	77.3	11.7	.4	10.6	.1	100.0	-2.0	1.3
Failure of a subprime lender to report a paid-as-agreed account									
Failure of largest student loan creditor to report	n.c.	7.2	52.4	19.8	13.1	7.6	100.0	-8.1	12.4
Failure to report a									
Minor delinquency	n.c.	5.8	26.0	22.7	38.5	7.0	100.0	-17.0	5.3
Credit limit	19.3	19.9	4.2	.1	37.7	38.1	100.0	-1.9	13.1
<i>Involving collection agency accounts</i>									
Failure to eliminate duplicate collection agency accounts									
Reporting of	6.8	5.2	1.4	.0	58.9	34.6	100.0	-1.5	10.6
Collection agency accounts under \$100	43.2	50.7	6.7	.3	40.4	2.0	100.0	-2.4	2.6
Medical collection accounts	51.6	18.0	4.1	.2	55.9	21.7	100.0	-2.7	8.0
Potentially misassigned collection accounts	23.5	22.6	5.7	.1	57.8	13.9	100.0	-1.6	6.4
<i>Involving public records</i>									
Reporting of duplicate public records									
Inclusion of lawsuits and dismissals	1.0	34.1	1.8	.0	63.7	.4	100.0	-3.8	1.8
Inclusion of lawsuits and dismissals	2.6	15.1	3.1	.3	59.8	21.7	100.0	-2.5	8.5
<i>Involving creditor inquiries</i>									
Failure to consolidate									
Multiple inquiries for auto and mortgage loans	4.3	27.7	23.5	3.7	44.4	.8	100.0	-4.6	2.2
Other multiple inquiries	28.2	8.5	13.1	.6	62.9	14.9	100.0	-2.9	6.5

NOTE. See note to table 3.

n.c. Not calculable.

to have only a modest effect on the credit history scores of affected individuals. For example, the simulation results indicate that if nonreporting by a subprime lender or by Sallie Mae had been corrected, in each case less than 5 percent of affected individuals would have gained 10 percentage points or more in their credit history scores. Moreover, such nonreporting may help or hurt the individuals. For example, the simulations suggest that, on average, consumers were helped by Sallie Mae's not reporting their loans, a somewhat surprising result. Fifty-eight percent of affected individuals would have experienced decreases in their credit history scores if the accounts had been reported. However, the median number of credit accounts for individuals with a corrected student loan account was twenty-two, a figure well above average for all individuals. Thus, the positive effects on credit history scores of reducing indi-

viduals' outstanding balances by not reporting their student loans may have outweighed the negative effects of eliminating one additional paid-as-agreed account.

We also could not determine the proportion of individuals affected by creditors' suppression of minor delinquencies; however, we could estimate the impact of the suppression on affected individuals. The simulation suggests that when suppression occurs, it is likely to improve the credit history scores of many affected individuals by a significant amount.

Effects of Unreported Credit Limits

Nonreporting of credit limits affects a substantial number of individuals (33 percent of the individuals

in the simulations), but the effect tends to be small. The likely reason for this result is that affected individuals tend to have a large number of credit accounts in their credit records (eighteen on average), while the frequency of accounts missing limits is low. Thus, accounts with missing limits tend to have a small effect on the overall utilization rates of individuals.

Unlike the results in most of the other simulations, the effects of missing credit limits were predominantly in one direction—most affected individuals' scores would have likely been higher if missing credit limits had been reported. This finding suggests that the rule that credit modelers typically adopt for addressing missing limits—use of the reported highest-balance amount—is likely biased. To further test this conjecture, we examined credit accounts for which the credit limit was reported and compared the actual limit with the estimated limit that credit modelers would have applied if the limit had not been reported. On average, the rule that the credit-reporting agencies used when they constructed utilization rates would imply a credit limit of less than one-half the actual limit. The rule would imply a lower credit limit than the actual limit in about 90 percent of the cases. In contrast, our rule, as noted earlier, was statistically unbiased.

Effects of Problems with Collection Agency Accounts, Public Records, and Creditor Inquiries

Results for eight simulations involving collection agency accounts, public records, and creditor inquiries were varied.

Collection Agency Accounts

The proportion of individuals affected by potential data problems or inconsistencies in reporting by collection agencies ranged from 16 percent for reporting of medical collection items to only about 1 percent for duplication of collection items, although, as noted, our ability to detect such duplications was limited. However, the effect of corrections on affected individuals tended to be large, particularly in comparison with simulated problems in credit accounts, and was generally associated with increases in credit history scores. For example, for three of the four collection account simulations, one-fourth or more of the affected individuals showed increases of 10 points or more in their scores. These results illustrate that

collection accounts weigh heavily in the scoring model and that most individuals have relatively few such accounts and thus are affected more significantly when a problem occurs in any given account.

Public Records

Both simulations that addressed potential data problems or inconsistencies in public records indicated that the proportion of individuals affected was small (1 percent or less). However, the effects of the corrections differed significantly between the two simulations. In the simulation involving duplicate public record items, less than 1 percent of affected individuals experienced increases in their credit history scores of 10 points or more, whereas in the simulation involving lawsuits and dismissals, nearly one-fourth of affected individuals did so. This dichotomy reflects an important distinction between duplicate public records and lawsuits and dismissals. Whereas removing a lawsuit or a dismissal may completely eliminate adverse public record items from an individual's credit record, eliminating a duplicate record cannot do so.

Creditor Inquiries

The simulation that consolidated inquiries related to auto and mortgage loans affected only 4 percent of individuals in the sample; the broader consolidation simulation affected about 15 percent of individuals. In both cases, the size of the effect was modest and almost always resulted in a higher score. Only a small percentage of individuals experienced increases in their scores of more than 10 points.

Differences across Subpopulations

Individuals with scores below 600 tended to have the highest frequency of data problems, and those with scores above 660 had the lowest incidence (table 4). Two exceptions to this pattern occurred in the simulations involving the failure to close stale paid-as-agreed accounts and the failure to report a credit limit. Here individuals in the highest score range showed the largest incidence of data problems primarily because they tended to have more credit accounts. Significant differences were also apparent in the impact of simulated corrections on affected individuals across the three groups. Generally, individuals with scores below 600 were the most likely to experience a score increase of 10 points or more in

5. Estimated effects of data “corrections” on the credit history scores of individuals with “thin” files, by data problem corrected
Percent except as noted

Data problem corrected	Individuals affected	Distribution of individuals affected					Total	Memo	
		Effect on credit history score						Mean change in points	
		No change	Decrease		Increase			Individuals with decrease in score	Individuals with increase in score
			1–9 points	10 or more points	1–9 points	10 or more points			
<i>Involving credit accounts</i>									
Failure to close a									
Paid-as-agreed account	3.2	3.6	21.7	44.1	15.8	14.9	100.0	-17.0	11.3
Minor delinquent account	.7	8.1	22.4	22.0	45.1	2.4	100.0	-16.0	3.7
Major derogatory account	2.4	88.7	5.4	.0	5.9	.0	100.0	-1.8	1.5
Failure of a subprime lender to report a paid-as-agreed account	n.c.	4.4	35.9	38.0	16.4	5.4	100.0	-12.3	6.8
Failure of largest student loan creditor to report	1.0	3.4	33.6	51.8	8.0	3.2	100.0	-20.8	6.8
Failure to report a									
Minor delinquency	n.c.	4.3	18.1	46.6	14.1	16.9	100.0	-24.9	9.8
Credit limit	9.1	18.2	1.4	.0	36.0	44.3	100.0	-1.2	13.2
<i>Involving collection agency accounts</i>									
Failure to eliminate duplicate collection agency accounts	1.9	7.4	.8	.0	82.4	9.5	100.0	-1.0	5.1
Reporting of									
Collection agency accounts under \$100	15.2	48.0	3.0	.6	35.8	12.6	100.0	-5.1	9.5
Medical collection accounts	20.9	10.6	1.7	.9	52.0	34.9	100.0	-8.7	14.7
Potentially misassigned collection accounts	8.6	16.3	4.1	3.1	32.7	43.7	100.0	-10.7	26.6
<i>Involving public records</i>									
Reporting of duplicate public records	.3	50.4	1.7	.0	47.9	.0	100.0	-1.0	1.0
Inclusion of lawsuits and dismissals	.7	22.4	1.6	.6	52.3	23.0	100.0	-6.3	13.4
<i>Involving creditor inquiries</i>									
Failure to consolidate									
Multiple inquiries for auto and mortgage loans	.9	19.1	7.2	.0	69.2	4.5	100.0	-2.1	3.4
Other multiple inquiries	9.5	4.9	3.4	.0	87.0	4.7	100.0	-1.5	4.8

NOTE. See note to table 3. A “thin” file has a record of a credit account but has fewer than four such accounts. n.c. Not calculable.

response to corrections of data problems. Collection account problems provided an exception to this pattern: Affected individuals in the credit history score range above 660 were the most likely to experience large score increases. The reason for this result is that relatively high-score individuals with collection agency accounts generally have no other major derogatory information in their credit records and thus can show significant score increases when a derogatory is corrected.

For individuals with thin files, the incidence of data quality issues involving credit accounts was generally lower than that for all individuals, but the incidence of issues involving collection agency accounts was somewhat higher (compare table 5 with table 3). The result regarding credit accounts reflects the smaller number of accounts in the credit records of individuals with thin files and, consequently, the generally lower probability that such individuals will have data quality issues. The result concerning collection agency accounts is due to the higher probability that people with thin files will have such accounts. However, in simulations involving corrections to

credit accounts, the effects on the credit history scores of individuals with thin files were either similar to or substantially larger than the effects on the scores of persons in the general population. For example, correcting a failure to close a paid-as-agreed account resulted in a decline in credit history score that was twice as large, on average, for individuals with thin files as it was for those in the population at large.

In general, older individuals and those living in higher-income and nonminority neighborhoods had the lowest incidence of data problems (table 6). The most-notable exception to this pattern was for failure to report a credit limit, which was less common among younger individuals and among individuals living in lower-income and predominantly minority neighborhoods. We do not report the changes in credit history scores of affected individuals for these decompositions of the sample because the comparisons are difficult to interpret without also accounting for differences in the incidence of thin files and in credit history scores across groups. In most cases, the effects of data quality problems were similar across groups after controlling for the differences in depth of

6. Share of individuals affected by data problems in credit records, distributed by selected demographic characteristics

Percent except as noted

Data problem	Age (years)			Income of census tract ¹			Share of minorities in census tract (percent)		
	Under 35	35–55	Over 55	Low or moderate	Middle	High	Less than 10	10–80	More than 80
<i>Involving credit accounts</i>									
Failure to close a									
Paid-as-agreed account	16.9	16.6	10.1	11.3	13.1	13.7	13.4	12.9	11.3
Minor delinquent account	2.0	1.4	.6	1.8	1.3	.8	1.0	1.3	2.1
Major derogatory account	5.5	6.2	2.9	6.8	4.7	3.1	3.2	5.1	8.0
Failure of a subprime lender to report									
a paid-as-agreed account	n.c.	n.c.	n.c.	n.c.	n.c.	n.c.	n.c.	n.c.	n.c.
Failure of largest student loan									
creditor to report	9.0	3.2	.8	3.4	3.3	3.8	3.0	3.8	3.3
Failure to report a									
Minor delinquency	n.c.	n.c.	n.c.	n.c.	n.c.	n.c.	n.c.	n.c.	n.c.
Credit limit	31.5	40.3	37.4	27.7	31.7	40.0	33.7	33.5	28.0
<i>Involving collection agency accounts</i>									
Failure to eliminate duplicate									
collection agency accounts	1.9	1.2	.4	2.3	1.1	.6	.7	1.4	2.7
Reporting of									
Collection agency accounts									
under \$100	15.1	11.5	5.0	17.0	11.1	6.4	8.7	11.7	16.9
Medical collection accounts	19.5	16.5	8.3	22.8	15.7	9.3	12.7	16.1	22.3
Potentially misassigned collection									
accounts	10.8	8.8	5.3	11.6	7.9	6.1	6.4	8.5	13.1
<i>Involving public records</i>									
Reporting of duplicate public records ...	.2	.5	.3	.4	.4	.3	.4	.4	.3
Inclusion of lawsuits and dismissals .....	.6	1.7	1.1	1.2	1.1	1.1	1.0	1.2	1.4
<i>Involving creditor inquiries</i>									
Failure to consolidate									
Multiple inquiries for auto and									
mortgage loans	5.4	5.3	2.1	3.3	3.7	3.9	3.8	3.7	3.3
Other multiple inquiries	19.6	17.7	10.0	15.9	14.1	14.6	12.8	15.3	17.5

NOTE. See note to table 3.

n.c. Not calculable.

1. For definition of income of census tract, see note to chart 2.

file and in credit history score. Exceptions generally involved instances in which either the youngest or the oldest age group was disproportionately affected. For example, individuals over age 55 were more likely to have increases of more than 10 points in their credit history scores when medical collections were dropped, and individuals under age 35 were more likely to have large increases in their scores when nonreporting of a credit limit was corrected.

SUMMARY AND CONCLUSIONS

Available evidence indicates that the information that credit-reporting 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 decisionmaking. The availability of these data has also greatly enhanced the process of screening prospective customers to facilitate the marketing of credit and insurance products, thereby reducing the costs of such marketing by limiting solicitations to

customers who are most likely to qualify for the products. If not for the information that the agencies maintain, consumers on the whole would receive less credit at higher prices. Moreover, the credit-reporting system has become more comprehensive over the past decade or so with notable improvements, such as the adoption of common formats for reporting information and the enhanced reporting of information on credit limits and mortgages. Recent congressional amendments to the FCRA have advanced prospects for future improvements as consumer access to credit records and credit history scores has improved.

Despite the benefits of the credit-reporting system, analysts have raised concerns about the accuracy, completeness, timeliness, and consistency of agency records and about the effects of these shortcomings on the cost and availability of credit. Clearly, for the benefits of the credit-reporting system to be realized, some reasonable degree of accuracy and completeness of credit reports is required. Moreover, the more accurate and complete the information assembled by credit-reporting agencies, the greater the potential for more efficiency in the credit-granting process and a reduction in costs to the advantage of both consumers

and creditors. Over the years, a number of studies have focused on the contents of credit records but have reached quite different conclusions about the degree to which such information is accurate and complete and about the implications of data limitations for credit availability and pricing.

This study extends earlier research and assesses the effects of data limitations and ambiguities in credit reports on the availability and pricing of credit by using a large, nationally representative sample of individuals with credit records from one of the three national credit-reporting agencies. Specifically, we estimate the proportion of individuals who are likely to be materially affected by a number of different data problems, and we quantify the likely effect of each problem on the credit history scores of individuals. Because such effects can vary across different populations, we also separately evaluate the effects on individuals in different credit-risk categories and in different groups classified by age and by income and minority population of the neighborhoods where they live. We emphasize that we use the terms “data problem” and “correction” in their broadest sense, as we do not necessarily observe actual errors and the appropriate correction is sometimes unclear.

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, with the exception of missing credit limits, which affected almost one-third of the individuals in the sample used for the simulations. Moreover, in most cases, the effect of each type of problem on the credit history scores of affected individuals was modest. Two principal reasons explain this result. First, most individuals have a large number of credit accounts, and thus problems in any given account have only a relatively small effect on the individuals’ overall credit profiles. Second, credit modelers recognize many of these data problems when they construct and weight the factors used in credit history scoring models. Therefore, correcting the problems identified here is unlikely to substantially change the risk evaluation and access to credit for the typical individual.

The analysis suggests, however, that the effects of data problems may be more substantial in some cases than in others. In particular, problems with collection accounts are much more likely to have significant effects on the credit history scores of affected individuals. Missing credit limits, simply because they occur so frequently, also represent an important data quality problem. In general, individuals with relatively low credit history scores or those with thin files are more likely to experience significant effects when

a data problem arises. The incidence of problems also varies across groups, with older individuals, those with higher credit history scores, and those living in higher-income and nonminority neighborhoods showing the lowest incidence.

Our analysis shows that predicting the effects of “correcting” errors is not straightforward. Sometimes, effects were counterintuitive. For example, our analysis suggests that about one-fourth of the individuals affected by lenders’ failure to report student loans would show increases in their credit history scores as a result. This outcome occurs in part because, somewhat surprisingly, individuals with student loans have more accounts than does the average individual. The complexity of the results is underscored by the fact that some individuals show increases and some show decreases for every simulation. In large part, this result occurs because the corrections typically affect more than one factor, moving scores in different directions. This is particularly true for problems with credit accounts, which are likely to involve multiple factors.

The research here highlights the importance of data reporters’ supplying complete information in a timely manner. How such reporting can be fully achieved in a voluntary system is unclear. The current system relies heavily on consumers to identify and dispute “incorrect” or missing items in their credit reports. One problem with this approach is that consumers have no incentive to challenge information that is favorable to them, even if it is in error. Our research indicates that even when data are incomplete or in error, they often have little or no bearing on an individual’s credit history score or access to credit.

Currently, consumers have access only to general information about the types of factors that are weighed in credit evaluation, or in the case of credit denials, the chief reasons for the adverse action. On the one hand, lack of specific information may lead some consumers to believe that virtually any data quality issue is pertinent and should be disputed, causing the credit-reporting agencies and reporters to incur unnecessary costs to correct or update files. On the other hand, consumers may be unaware of the potential importance of specific data issues, such as missing credit limits, and may not take appropriate action. Some of these problems may be addressed by consumer education, whereas others are likely to continue for the foreseeable future.

Before these results are taken as definitive estimates of the effects of data quality issues on credit availability, several important caveats must be made. First, we have investigated only some potential sources of error. Most notably, we can say nothing

about the consequences of mistakenly including account records that do not belong to an individual in the individual's file. Second, we have used only one credit-scoring model to simulate our results and have relied on our approximation to the model to quantify our results. Third, we have omitted manual reviews of credit records, which are part of many underwriting systems. Such systems identify and address many data quality issues. Finally, we have used data from only one credit-reporting agency. Creditors, particularly in the mortgage market, typically obtain data from all three national credit-reporting agencies for credit underwriting. Reconciling inconsistencies in data across the three agencies can lead to corrections of many of the data quality issues we have identified.

Moreover, we have analyzed only the potential effects on credit history scores of addressing data quality issues. We have said nothing about how such

problems could be corrected, how much the corrections might cost, or what potential gains in efficiency might result from developing models based on more complete and accurate data. If the current level of accuracy and completeness is socially inefficient, reaching the optimal level may be difficult. Credit information has aspects of a classic public good. The parties that bear the costs of correcting errors or providing more timely and complete information may not receive much benefit from the improvement in accuracy. Further remedies, such as imposing additional legal liability penalties, may, in a system of voluntary reporting, lead to unintended consequences, including less information reporting and a less efficient and effective system. Policymakers need to weigh all of these considerations when they determine whether the current credit-reporting system should be changed and, if so, what changes should be made. □



Consumer Federation of America



**Credit Score Accuracy and Implications for Consumers
December 17, 2002**

**Consumer Federation of America
National Credit Reporting Association**

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I. About Privacy

The Consumer Federation of America (CFA) and the National Credit Reporting Association (NCRA) designed the details of this study with advice from legal counsel to ensure the methodology would comply with the requirements of the Fair Credit Reporting Act, Gramm Leach Bliley Act, and other consumer privacy laws. From the outset, each organization was mindful of the ethical spirit and intent of these consumer protection and privacy laws. In this day of rampant identification theft, we carefully evaluated each segment of the study workflow to ensure that we analyzed data extracted from the credit files without any trace of personal identifiers. Regarding consumer identity, all non-public, personal information data was completely “blind” as to a source for analysis. No names, addresses, social security numbers, dates of birth, account numbers, or any other item that could be used in any way to trace back to a specific consumer were revealed to or recorded by any third party outside trusted personnel of the consumer reporting agencies involved in the study. In one phase of the study the recorded data segment closest to the consumer was the postal zip code of their residence.

After CFA made a random selection of the time frame from which credit files were to be analyzed, a generic number was assigned to keep the nameless study data from each study file separated from other study files. No copies or partial copies of any credit reports, on paper or electronically, were removed from any credit reporting agency location. Anonymous credit scores and an analysis of the credit data, as reviewed by credit reporting agency personnel for security and industry knowledge, was supervised and recorded by the CFA researcher for tabulation. The data elements recorded in this study are insufficient to ever be used to track or identify any individual. Further, the analytical data recorded, if ever obtained by unscrupulous individuals, contains no information that could ever be used to try to defraud any of the consumers or creditors connected to the files in the study. Total anonymity to consumer identity and creditor accounts was, and will continue to be, strictly enforced.

II. The Growing Importance of Credit Scores

Consumer access to credit, housing, insurance, basic utility services, and even employment is increasingly determined by centralized records of credit history and automated interpretations of those records.

Credit histories in one form or another have long been an important factor in decisions to extend or deny credit to consumers¹. Historically, such decisions required a skilled, human evaluation of the information in an applicant's credit history to determine the likelihood that the applicant would repay a future loan in a timely manner. More recently, computer models have been developed to perform such evaluations. These models produce numerical credit scores that function as a shorthand version of an applicant's credit history to facilitate quick credit assessments.

During the second half of the 1990s, mortgage underwriting increasingly incorporated credit scores and other automated evaluations of credit histories. As of 1999, approximately 60 to 70 percent of all mortgages were underwritten using an automated evaluation of credit, and the share was rising².

The automated quantification of the information in credit reports has not simply been used to decide whether or not to extend credit, but has also been used to set prices and terms for mortgages and other consumer credit. In certain cases, even very small differences in scores can result in substantially higher interest rates, and less favorable loan terms on new loans. Credit scores are also used to determine the cost of private mortgage insurance, which protects the lender, not the consumer, from loss but is required on mortgages with down payments of less than twenty percent³. Lenders also review credit histories and/or credit scores to evaluate existing credit accounts, and use the information when deciding to change credit limits, interest rates, or other terms on those accounts.

In addition to lenders, potential landlords and employers may review credit histories and/or credit scores. Landlords may do so to determine if potential tenants are likely to pay their rent in a timely manner. Employers may review this information during a hiring process, especially for positions where employees are responsible for handling large sums of money. Utility providers, home telephone, and cell phone service providers also may request a credit report or credit score to decide whether or not to offer service to consumers.

Insurance companies have also begun using credit scores and similar insurance scores – that are derived from the same credit histories – when underwriting consumer applications for new insurance and renewals of existing policies. Credit information has

¹ Klein, Daniel. 2001. Credit Information Reporting. Why Free Speech is Vital to Social Accountability and Consumer Opportunity. *The Independent Review*. Volume V, number 3.

² Straka, John. 2000. A Shift in the Mortgage Landscape: the 1990s Move to Automated Credit Evaluations. *Journal of Housing Research*. Volume 11, Issue 2.

³ Harney, Ken. August 18, 2002. "Risk-based pricing brings a big rate hike for some." *Washington Post*.

been used as a basis to raise premiums, deny coverage for new customers, and deny renewals of existing customers – even in the absence of other risk factors, such as moving violations or accidents. Some providers claim that credit scores are also used to offer insurance coverage to consumers who have previously been denied, or to lower insurance rates. This is a highly contested issue that is under review in dozens of state legislatures and insurance commissions.

Thus, a consumer's credit record and corresponding credit score can determine access and pricing for the most fundamental financial and consumer services.

III. Controversial Issues Affecting Consumers

The expanded use of automated credit evaluations has brought changes to the marketplace that have benefited consumers. However, given the tremendous impact credit scores can have on consumers' ability to access and afford basic necessities, the increased application of this tool has also raised serious concerns about the potential harm it can cause.

A. *Speed*

The growth in use of credit scores has dramatically increased the speed at which many credit decisions can be made. Especially for consumers with relatively good credit, approvals for loans can be given in a fraction of the time previously required, without any manual review of the information. It is unlikely that underwriting the recent record volumes of mortgage originations would have been possible without the efficiencies provided by credit scoring.

B. *Customized or Risk-Based Pricing*

Credit scores, as a quantitative shorthand for credit histories, increase the potential for customized pricing of credit based on the risk an individual poses. Some argue that charging more to consumers defined as higher risk would remove some of the cost of risk carried by the general consumer population, and would allow for price reductions among consumers who pose less risk. Others argue that the savings have not been – and are unlikely to be – passed on to consumers who pose less risk, and scoring systems simply allow lenders to extract greater profits from consumers who do not attain target credit scores. The potential for increased profits from consumers whose credit is scored low also creates a disincentive to helping consumers correct errors in their credit records.

The increased speed at which underwriting decisions can be made has created pressure to complete credit applications more quickly. Some contend that the combination of this increased pace and the increased ability to customize the price charged based on credit allows lenders to approve a larger share of consumers for loans, but not necessarily at the best rates for which they qualify. While many consumers can feel overwhelmed by large credit based transactions, such as mortgage closings, consumers who do not have a solid understanding of credit scores, or who do not objectively know their creditworthiness, are even more vulnerable to high-pressure tactics to accept any offer of credit, regardless of terms, and may unnecessarily be charged higher rates.

C. *Effect on Discrimination*

Some have argued that increased reliance on automated reviews of credit has the potential to reduce discrimination in lending because the automation of decision-making removes or reduces the influence of subjective bias. Others have argued that the factors used to determine a credit score may not completely remove bias from approval and pricing decisions. Furthermore, lenders are still free to offer differential levels of

assistance in dealing with errors in credit records, or with other issues related to credit scores, such as providing rescoring services. Such discretionary assistance remains a potential source of bias in the approval process whether a consumer is underwritten with an automated system or with manual underwriting. Federal banking regulators do conduct examinations to ensure against overt discrimination on prohibited bases such as race, sex, marital status, or age in credit score design or in lenders' application of those scoring systems, such as through the use of overrides⁴.

D. Statistical Validity

Supporters of credit scoring note that credit scores have statistical validity, and are predictive of repayment behavior for large populations. However, this does not mean that credit data are error free, nor that credit scoring models are perfect predictors of individual creditworthiness; it only means that they work on average. While the systems do present an accurate risk profile of a large numbers of consumers, data users who manage large numbers of accounts priced by credit risk have a greater tolerance for errors in credit scoring systems than consumers do. Among those consumers who are inaccurately characterized, businesses can balance errors in their favor against errors in favor of consumers; so long as enough consumers are charged higher rates based on inflated risk assessments to cover the losses from those who are charged lower rates because the systems incorrectly identified them as low risk, these businesses will suffer no material harm. Consumers on the other hand do not have a similar tolerance for errors in transactions governed by credit reports and credit scores. If they are overcharged because of an error in the credit scoring system, there is no countervailing rebate to set the statistical scales even. Credit scores should not function as a lottery in which some consumers "win" by being viewed more favorably than they deserve to be, while others "lose" by being viewed less favorably than they should be.

While debate surrounding the broad implications of credit scoring continues, its use is already strongly established in the American financial services industry. Meanwhile, concern over the integrity of credit scoring itself focuses on two dimensions – the fairness of the models that interpret the data and the accuracy of the underlying credit related data.

E. Untested Scoring Formulas

Even if all credit data regarding consumers held at credit repositories were accurate, complete, and current, there would be significant concerns about the fairness of automated credit scoring programs. Converting the complex and often conflicting information contained in credit reports into a numerical shorthand is a complex process, and requires a significant number of interpretive decisions to be made at the design level. From determining the relative influence of various credit-related behaviors, to the process used to evaluate inconsistent information, there is a great potential for variance among scoring system designs.

⁴ See for example Appendix B of the Office of the Comptroller of the Currency's *Comptroller's Handbook for Compliance, Fair Lending Examination Procedures*, available at <http://www.occ.treas.gov/handbook/fairlep.pdf>

Despite the gatekeeper role that these scoring systems play regarding access to credit, housing, insurance, utilities, and employment, as well as pricing for those essentials, exactly how the formulas perform the transformation from credit report to credit score is a closely guarded secret. For consumers, regulators, and even industry participants who rely on the computations in their decision-making, the scoring models largely remain a “black box.” No scholarly reviews of this extremely powerful market force have been permitted, and apart from reviews by federal banking regulators to protect against discrimination no government regulator has insisted that they be examined to ensure that they are adequate and fair.

Recently, after California passed a law requiring all consumers in the state to have access to their credit scores, several companies, including Fair, Isaac, and Company, Equifax, Experian, and Trans Union, Fannie Mae, and Freddie Mac have voluntarily provided general information about the information that is used to calculate a credit score or to evaluate a mortgage application, and how that information is generally weighted. In addition, for a fee, consumers can access score simulators that give some approximation of the impact of various behaviors on their credit scores.

F. Inaccurate credit reports

The most fundamental issue connected to credit scoring is the level of accuracy of the information that forms the basis for the scores. Regardless of whether lending and pricing decisions are made by a manual or automated review of a consumer’s credit, the potential for inaccuracies in credit reports to result in loan denials or higher borrowing costs is a cause for concern. Several organizations have conducted studies and surveys to quantify the pervasiveness of credit report errors, with widely ranging findings regarding how many credit reports contain errors (from 0.2% to 70%).

A 1998 study by the Public Interest Research Group⁵ found that 29% of credit reports contained errors that could result in the denial of credit (defined as false delinquencies, or reports listing accounts or public records that did not belong to the consumer). The study also found that 41% of reports had incorrect demographic identifying information, and 20% were missing major credit cards, loans, or mortgages. In total, 70% of reports contained an error of some kind. This study asked 88 consumers to review their credit reports from each of the three major credit repositories for errors. A total of 133 reports were reviewed.

Consumers Union has conducted two surveys of credit reports in which consumers were asked to review their credit reports for accuracy. A 1991 survey⁶ found that 20% of credit reports contained a major inaccuracy that could affect a consumer’s eligibility for credit, and 48% contained inaccurate information of some kind. In addition, almost half of survey respondents found that their reports omitted some of their current accounts. In

⁵ *Mistakes Do Happen*. Public Interest Research Group. March, 1998.

⁶ “Credit Reports: Getting it Half Right.” *Consumer Reports*. July, 1991. p. 453.

this survey, 57 consumers reviewed total of 161 reports. A 2000 survey⁷ found that more than 50% of credit reports contained inaccuracies with the potential to result in a denial, or a higher cost of credit. The errors included mistaken identities, misapplied charges, uncorrected errors, misleading information, and variation between information reported by the various credit repositories. These results reflect the review of 63 reports by 25 consumers.

A 1992 study conducted by Arthur Andersen⁸, commissioned by the Associated Credit Bureaus (now known as the Consumer Data Industry Association) used a different methodology to conclude that the error rate was much lower. This study reviewed the behavior of 15,703 consumers who were denied credit based on a credit grantor's scoring system. From this sample, 1,223 consumers (7.8%) requested their credit report from the issuing credit repository, and 304 consumers (1.9% of the total sample) disputed the information on the report. Of these, 36 disputes (11.8% of those who disputed, or 0.2% of the total sample) resulted in reversals of the original credit denial.

A 1994 study conducted by the National Association of Independent Credit Reporting Agencies (now known as the National Credit Reporting Association) represents a third approach to the question of credit report accuracy. Examining a total of 1,710 files, this study reviewed a three-repository merged infile (which contains the credit reports from all three credit repositories), and conducted a two-repository Residential Mortgage Credit Report, or RMCR (in which all conflicting data in the two credit repository reports and the application form is verified with each creditor, and a consumer interview is conducted) for each file. The results showed missing, duplicated, and outdated information in credit files. Among the three-repository merged infiles: 29% of accounts, also known as trade lines or trades (past and current loans, lines of credit, collections, etc.), were duplicates, 15% of inquiries were duplicates, 26% of public records were duplicates, 19% had outdated trades, and 44% had missing information, such as balance or payment information. Among the RMCRs: 19% had trades added based on information from the loan application, 11% had trades added based on investigations, 16.5% had derogatory information deleted as a result of the investigation, 3% had trades removed because they did not belong to the borrower, and 2% had errors in public records corrected.

⁷ "Credit Reports: How do potential lenders see you?" *Consumer Reports*. July 2000. P. 52-3.

⁸ Described and cited in Klein, Daniel, and Jason Richner. 1992. "In Defense of the Credit Bureau." *Cato Journal*. Vol 12. Issue 2. pp. 393 - 411.

IV. How Does the System Work?

The complex system for reporting and reviewing credit involves a large number of participants who fall generally into one of six categories: consumers; data repositories; data users; data furnishers; credit reporting agencies; and analytical service providers. Approximately 190-200 million consumers have credit reports maintained by the three major credit repositories (Experian, Equifax, and Trans Union)⁹. Data users include lenders, insurers, landlords, utility companies, and employers, who review the credit information in consumers' credit reports to make decisions about extending and pricing credit, offering and pricing insurance policies, and providing utility services, rental housing, or offers of employment. Some, but not all, data users are also data furnishers, and regularly report information about consumers' accounts to the credit repositories, who add the information to consumers' credit reports. It is the understanding of the researchers that there is currently no legal requirement that any business report information to any credit bureau, although once a business furnishes data, there may be certain obligations that arise in connection with consumer disputes. In 1996, Congress recognized that errors by data furnishers contributed to credit reporting problems, so the Fair Credit Reporting Act was amended to impose accuracy duties on data furnishers. These duties are generally subject only to administrative enforcement under the FCRA, with no private right of action for consumers unless the data furnisher fails to comply with re-investigation duties.

Generally, insurers, landlords, utility companies, and employers do not provide positive account information to repositories, nor do all lenders. Also, data enters consumers' records from collection agencies that report on the status of accounts in collection, and

⁹ Credit repositories attempt to maintain the following information in their databases, but not all data is available or provided for every account, and different repositories may collect different levels of information, especially consumer identifying information:

Consumer identifying information (Consumer's name; social security number; date of birth; former names or aliases; current and former addresses; employer; income; position; and employer's address)

Public records information (source of information; date recorded; amount of liability; type of record (e.g. judgment, tax lien, or bankruptcy); docket number)

Collections information (collections company's name; date opened; last date verified or updated by collections company; date closed; the amount placed for collection; balance outstanding; name of original creditor; the method of payment (a numerical code indicating if the account is current, late, in collection, etc.); any remarks)

Creditor information (creditor's name; account number; level of responsibility for consumer to pay account (primary account holder, joint account, authorized user, etc.); type of loan (revolving, installment, mortgage, line of credit, etc.) or collateral for an installment loan; date opened; date of last activity; date closed or paid; highest amount ever owed by consumer; the credit limit on the account; the balance due; payment size and frequency; any amount past due; date of maximum delinquency; dollar amount of maximum delinquency; payment pattern for last 12-24 months (indicating for every month whether the account was paid as agreed, or late, and by how many days); the number of months reviewed; number of times account was late by 30, 60, or 90 days; the method of payment (a numerical code indicating if the account is current, late, in collection, etc.); any remarks)

Credit Inquiries (list of companies who have requested consumer credit information; date the inquiry was made)

Any consumer statement, such as an explanation of a dispute

from repository searches of public records such as bankruptcies, liens, and judgments. In addition, governments may report directly to the repositories if consumers fail to pay child support, have unpaid parking tickets, or have been overpaid for unemployment benefits. Credit reporting agencies assist some data users by consolidating information from the three credit repositories, and offering services to verify and update information in credit reports. Credit reporting agencies primarily facilitate and support the decision making process involved with mortgage underwriting. Credit reporting agencies and credit repositories both provide credit reports to data users, and are considered “consumer reporting agencies” under the Fair Credit Reporting Act. As consumer reporting agencies, these entities share certain obligations, some of which are described below. Analytic service providers also help data users interpret the information in consumers’ files, and include companies such as Fair, Isaac, and Company, which produces analytical tools that generate credit scores, and the Government Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac, who produce tools that help lenders interpret credit information in conjunction with mortgage applications. Some lenders and mortgage insurance companies have also created tools that help them interpret credit information for mortgage applications.

A. Non-Mortgage Credit

When a consumer applies for non-mortgage credit, such as a credit card, unsecured line of credit, or installment loan (e.g. for an automobile, or furniture), the potential creditor (data user) can request a credit report (with or without a credit score) from one, two, or three of the credit repositories. A repository that receives such a request will send the credit report to the potential creditor, and record an inquiry on the consumer’s credit report. The creditor can use the information in the credit report to help decide whether to extend or deny credit to the consumer, and what the interest rate and other fees will be for this credit. If the creditor accepts the application, they may then act as a data provider, and report information on the consumer’s payment history to one, two, or three of the credit repositories. Generally account information can be both positive and negative. On-time payments have a positive influence while late payments have a negative influence. However, the amount of positive influence a consumer receives from a timely payment may vary based on the type of creditor. For example, timely payments to a prime credit card lender may have a greater positive influence on a score than timely payments to a lender considered less favorable, such as a furniture or consumer electronics store. If the creditor denies credit, or offers less than favorable terms, based on the credit report or score, federal laws require them to make certain disclosures to the consumer, including the name of the consumer reporting agency that supplied the credit report and how to contact the agency. For non-mortgage applications the consumer reporting agency is usually a credit repository. Once given this information, the consumer can contact the repository to request a copy of his or her credit report¹⁰. If the

¹⁰ However, the report the consumer receives may differ from the report that the lender reviewed. If consumers submit more comprehensive personal identifiers in their request for a report from the credit repository, they may not see the exact report that was used to underwrite their credit application, especially if the underwriter made any errors such as misspellings in the consumer’s name or transposing digits in the consumer’s social security number, or merely submitted an application with less information about the

consumer has suffered an adverse action based on the credit report, the copy must be provided by the repository free of charge. Consumers who have not suffered an adverse action can also review their credit reports at any time, but are subject to a fee of approximately \$9. Six states (Colorado, Georgia, Maryland, Massachusetts, New Jersey, and Vermont) require repositories to provide credit reports to consumers free of charge once a year upon request. Also, if a consumer is receiving welfare, is unemployed, or suspects that he or she is a victim of identity theft, the consumer may obtain a credit report free of charge. For an additional charge, the consumer can have a credit score computed and included with the credit report under any of these circumstances.

B. Employment and Services Other Than Loans

When a consumer applies for employment, or for a service that reviews credit histories, (such as insurance, an apartment rental, utilities, cell phone accounts) these data users may also request and receive a credit report and/or scores from one or more repositories, to be used to evaluate the consumer's application. Job applicants or employees must provide consent before a report is pulled, but other users derive a permissible purpose to review credit from the consumer's act of submitting an application, except in Vermont, where oral consent is required to review a credit report for credit uses.

However, while these entities will review credit, and approve or deny the application based on the credit report and/or score, they generally *do not* report positive account information back to the credit repositories. They often, however, indirectly report derogatory information by placing accounts for collection. Accounts that have been placed for collection will be reported to one or more of the credit repositories.

C. Other Data Providers

The reverse is true of collection agencies, which provide information to the repositories, but do not use credit data to evaluate consumer creditworthiness, although they may use information in credit reports to locate debtors. Repositories also obtain information by requesting it from public records and government entities and when certain government entities report directly to the repositories, such as for delinquent child or family support payments, unpaid parking tickets, or overpayments of unemployment benefits. Information from collection agencies and public records is primarily derogatory information, such as when an account was sent to collection, or a bankruptcy was filed, but may also include positive information such as the satisfaction of a bankruptcy or the repayment of a collection, and when such repayments occurred. Because government entities do not report information about bankruptcies, liens, civil suits, or judgments to repositories, the repositories are responsible for maintaining the accuracy of such public record information in credit records, such as whether a bankruptcy has been satisfied or a lien has been released. Any type of collection will have a negative impact on a credit history, regardless of whether the debt was related to an account for which a credit report was used to establish credit (e.g. for loans or utilities, as well as for child or family

consumer's identity. While there is no legal prohibition on lenders providing consumers with the actual credit report used in their decision-making process, there is likewise no requirement that they provide it.

support or parking tickets). Collections, either from a collection agency or other type of account, and public records will continue to have a negative impact after they have been paid or otherwise satisfied, although they will have a less negative impact if they are satisfied, and will have a less negative impact as time passes.

D. Mortgage Credit

The process is more complex for a mortgage transaction. When consumers apply for a mortgage, the mortgage lender (who may be a mortgage banker or mortgage broker) has a number of options that are influenced by what the lender intends to do with the loan after the closing. The lender can hold onto the loan and collect mortgage payments from the consumer until the loan is paid off (known as holding a loan in portfolio), thereby assuming all the risk for borrowers defaulting, or the lender can sell the loan to the secondary market. If a loan is sold, the originator loses the access to future profits from mortgage payments, but also, so long as the loan meets all the standards set forth by the purchaser of the loan, retains no risk should the borrower default. The originator retains the profits from the cost of the mortgage transaction and underwriting, and has a replenished supply of capital to make other loans. The two primary purchasers of loans in the secondary market are the government sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. Lenders may also seek a government guarantee for the loan through the Federal Housing Administration (FHA) or Department of Veterans' Affairs (VA) programs.

1. Portfolio Loans

If a lender is not planning to sell the loan to the secondary market, that lender will usually order a merged credit report, which incorporates information from all three credit repositories, including the three credit scores. While a lender will generally use reports from all three repositories to underwrite a loan, it may use a single credit report to offer a pre-approval. Also, for second mortgages and lines of credit secured by the home, lenders generally underwrite using one credit report. There is no legal or regulatory requirement to use a certain number of credit reports to underwrite a mortgage. However, if a lender wishes to sell the loan on the secondary market, or receive an FHA or VA guarantee on the loan it may be required to follow certain protocols.

A lender planning to hold a loan in portfolio will order a merged credit report with scores from a credit reporting agency, passing on information about the consumer such as name, social security number, current and previous addresses. The credit reporting agency will then pass on the request to a merging company, which will request credit reports from all three credit repositories and will compile the information from each report returned to them, according to their merging logic (a set of automated commands designed to identify shared information and present the three reports in a summarized format). The individual credit reports as they read prior to merging and credit scores are also returned to credit reporting agency. The credit reporting agency will then supply this information to the lender.

Based on the information in this report, and other information such as the applicant's income and the loan to value ratio of the mortgage requested, a lender will decide whether or not to originate the loan, and at what price (interest rate, points, etc.). A number of companies, such as mortgage lenders Countrywide and GE Capital and mortgage insurers PMI Mortgage Insurance Company and Mortgage Guarantee Insurance Corporation, have developed automated underwriting (AU) systems that can provide automated evaluations of a loan application based on information from the consumer's credit report and additional information such as income and loan to value ratio.

If the lender is hesitant to originate a loan because of derogatory information in an applicant's credit report, and has reason to believe that it may be incorrect, or outdated, the lender can purchase a reinvestigation of the credit information from the credit reporting agency. This entails contacting original creditors, collection agencies, and government records clerks, to verify and update questionable information contained in the merged credit file. These services can mean corroborating as few as one entry in a credit file, or it can be a comprehensive review in which every entry with conflicting information is corroborated. An alternative called a Residential Mortgage Credit Report (RMCR) involves reviewing two or three credit repository reports, verifying all conflicting data in the credit repository reports and the application form with each creditor, updating any account with a balance over 90 days old, conducting a consumer interview, and other verification services. Such services provide more current information to a lender for their consideration when underwriting a mortgage, but they do not alter information maintained by any of the credit repositories, nor do they change a borrower's credit score¹¹. A credit reporting agency may have greater success obtaining clarification of inconsistencies in an applicant's record than the applicant would have acting on his or her own, and the credit reporting agency's reinvestigation is more likely to be trusted by the lender than the word of a consumer regarding current status of accounts. This service adds cost to the credit underwriting process (roughly \$50-100). For consumers who have credit scores far higher than the requirements to qualify, this would be an unnecessary service. However, for those who face loan denial, or dramatically higher borrowing costs because of errors in their reports, the savings over the life of the loan, or in some cases with a single mortgage payment, could more than compensate for the increased cost of this reinvestigation. After the reinvestigation, the credit reporting agency will provide the updated and verified information to a lender who can consider the information while making the final underwriting decision¹².

¹¹ When a reinvestigation produces changes in the information contained in a repository's credit report, the credit reporting agency is required to pass the information on to the repository within 30 days. However, once this occurs, there is no requirement that the repository update the consumer's credit file, nor a time frame within which they must respond. It would be far better for consumers if the credit repositories were under an obligation to update the consumer's file, or at the very least to respond with the results of their own reinvestigation within 30 days. In the mean time, the disputed information should be part of the credit report provided to any data users who request the file as the reinvestigation is underway.

¹² Lenders are not required to accept the results of a reinvestigation, and the automated underwriting systems of key secondary market actors Fannie Mae and Freddie Mac do not. Instead they require all changes to be made through a process known as rescoring, described in greater detail below.

2. Loans Sold in the Secondary Market

In the current marketplace, few loans are held in portfolio, especially those loans originated by brokers. Instead, many are sold into the secondary market to entities that bundle large numbers of mortgages into securities that are sold to investors – a process known as securitization. The major actors in this part of the market are the Government Sponsored Enterprises Fannie Mae and Freddie Mac, although a number of large national lenders also purchase and securitize loans. If mortgage originators can sell a loan, then they will have renewed capital to make another loan, and will still have profit derived from the costs charged to the consumer for the transaction. Thus selling a loan into the secondary market is an attractive option.

Government Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac have both developed automated underwriting systems which evaluate mortgage applications based on the information in credit reports, as well as additional information such as income and loan to value ratio, in a very short amount of time. Lenders can submit a loan application to these automated underwriting systems prior to approving a loan and receive an indication from the GSE that they will purchase the loan. Each GSE has a different protocol for submitting loan applications and for obtaining and using credit histories.

Automated underwriting (AU) systems do not approve or deny loans, but can provide an indication of whether a GSE will purchase the loan, and thereby assume the risk of default with respect to the loan. A lender can override an AU decision and underwrite the loan manually, but if they do so, they must agree to buy back the loan if it defaults and is found to have violated the purchaser's loan standards. While a loan with an AU approval that meets all the purchaser's standards and complies with the warranties of sale carries no risk for a lender or broker, a loan that has been approved by overriding AU standards does carry significant risk. Many loans are still manually underwritten, but the majority of applications are reviewed with an automated underwriting system, and this share is expected to grow in coming years.

Brokers are the dominant originators of loans, but they do not have the financial reserves of banks, thrifts, and other financial institutions. They rely on being able to sell their loans almost immediately. This is much more difficult without an AU approval. Also, the efficiencies of credit scoring and automated underwriting have made the loan approval process so fast for loans with good credit that the additional effort required to correct errors, or otherwise revisit the details of the loan file, acts as a substantial deterrent to mortgage lenders working on these loans. In this market, where record volumes of loans are being originated, there is a tremendous incentive to deal only with the loans that will be approved the fastest – the loans that pass the credit score/ automated underwriting test¹³.

¹³ The economic pressure on originators to underwrite loans that will require the least amount of work existed prior to the introduction of automated underwriting systems. However, the development of automated underwriting has made the process so quick for some loans that the relative additional time required to complete a more complicated loan is proportionally greater. Some have noted that decreasing

3. Credit Rescoring

If lenders wish to update or correct information in a credit report, the lender cannot use the reinvestigation process for portfolio loans outlined above and resubmit the loan through the automated underwriting systems of Fannie Mae and Freddie Mac. The reinvestigation process outlined above does not change the data on record at the repositories and only reports that contain credit scores and have been generated at the repository level are acceptable for submission to Fannie Mae's and Freddie Mac's automated underwriting systems. Lenders can choose to manually underwrite the loan and submit it with documentation of the errors in the first credit report.

If a lender is unwilling to underwrite the loan manually, and a consumer can afford to wait several weeks, the consumer can submit a dispute directly to the credit repository, and the repository has 30 days to respond to the dispute. However, if the borrower wishes to correct an error in an expedited time frame, lenders who submit loans through automatic underwriting systems would have to order a service known as *rescoring*. In this process, the credit reporting agency will obtain the necessary documentation regarding the disputed account or accounts and contact the rescoring department within the relevant repository. This department will verify the information provided to them by the credit reporting agency, either through spot checks, or by verification of every update, within a few days. After this process is complete, a new credit report with new credit scores can be requested, and the loan can be underwritten with the more current information. In addition, the information is changed at the repository level, and will be reflected in future credit reports for this consumer. This has recently become a very expensive service for a lender to purchase. Since the summer, two of the three repositories have increased prices for this service by as much as 400%¹⁴.

Regardless of how the underwriting takes place, if the loan is originated, the mortgage lender, or the entity holding and servicing the loan if it is sold, may become a data provider. The servicer will report information about consumer's payment behavior related to their mortgage to one, two, or three of the credit repositories, who will add this information to the credit report.

the time required to underwrite the easiest loans potentially frees underwriters to devote more time to more difficult loans.

¹⁴ According to reports from a number of credit reporting agencies, Transunion and Equifax have recently changed their pricing. Transunion previously charged \$5.00 per account entry, or trade line, regardless of whether the account to be updated was a joint or individual account. As of June of this year, Transunion charges \$20 per trade line to update an individual account, and \$25 to update a joint account. Equifax has recently increased the cost from approximately \$5 per rescore to \$15 per tradeline for a joint or individual account, or \$30 for a same day request. Both repositories have clearly stated that these costs are not to be passed on to the consumer. It is also of note that these two repositories compete with credit reporting agencies in offering rescoring services, and charge between \$8-10 per trade line to lenders who contact them directly.

4. Federal Housing Administration (FHA) and Department of Veterans' Affairs (VA) Loans

Lenders who wish to submit loans for an FHA or VA guarantee must also follow certain protocols regarding the submission of credit reports, but have a number of options to choose from. For example, the FHA program accepts either a three repository merged credit report, a Residential Mortgage Credit Report (RMCR), or applications processed through the automated underwriting systems of Fannie Mae and Freddie Mac. The RMCR option is required to be made available to consumers who dispute information contained in their credit reports¹⁵. In addition to the options offered to lenders submitting loans for FHA guarantees, the VA program accepts applications processed through the automated underwriting systems of PMI Mortgage Insurance Company and Countrywide¹⁶.

¹⁵ See FHA Lender's Handbook number 4155.1 chapter 2, section 4 "Credit Report Requirements," and Mortgagee Letters 98-14 and 99-26, available at www.hudclips.org.

¹⁶ See VA Lender's Handbook, VA Pamphlet 26-7, available at <http://www.homeloans.va.gov/26-7.pdf>.

V. Study Design

A. Phase One

The first phase of the study consisted of a manual review of 1704 credit files, archived by credit reporting agencies. These files had been requested by mortgage lenders on behalf of consumers actively seeking mortgages. The three credit reporting agencies that generated these files are located in different regions of the county (West, Midwest, and East) and serve mortgage lenders in a total of 22 states.

Only archived credit files that had been generated by mortgage lender requests for reports and scores from all three major credit repositories (Experian, Equifax, and Trans Union) were included in the review. Files were included in the study by reviewing consecutive archived files dating from June 17 to June 20, 2002¹⁷.

Ensuring the anonymity of all data collected and examined for this study was a paramount concern for both CFA and NCRA. The data collection procedures were designed with particular care to ensure that no personal identifying information from these credit files was recorded for this study. No reports were provided in paper or electronic form, and no names, social security numbers, account numbers, addresses, or other consumer identifying information was recorded. All comments regarding inconsistencies were recorded in generic form. For example, the fact that digits in a social security number were transposed in one file would have been recorded, but the actual number would not have been. Similarly, if a consumer's file showed apparent confusion between credit data recorded under a consumer's first name and credit recorded under the consumer's middle name, this would have been noted, but the names would not have been recorded. While the files were being reviewed, the National Credit Reporting Association (NCRA) and the Consumer Federation of America (CFA) took precautions to limit the access to identifying information to the credit reporting agencies' representatives, who worked with a representative from the Consumer Federation of America in each office. The credit reporting agency representative retrieved the files, and conveyed only the relevant generic information verbally to the CFA representative for recording. As a result, the data examined for this study contains only generic information about variations in credit data, but does not link that data to any consumer or consumers.

For each file, the credit scores from each of the three major credit repositories were recorded. If a repository returned a report, but the report was not scored, or if the repository could not locate a report for the applicant, this information was also recorded. In addition, researchers noted if a file contained multiple reports from any repository, and recorded the scores for these reports, if the report was scored. Residential Mortgage Credit Reports (RMCRs), for which credit reporting agencies verify and update

¹⁷ For agencies that serve multiple time zones, additional measures were employed to include records from consumers in all regions. For example, every second file from one agency was reviewed rather than every file.

information in the credit report, were identified as such¹⁸. For joint application files, the applicant's and coapplicant's reports were treated as separate reports. Approximately 500 files that contained a credit score from each of the three repositories were recorded at each agency.

A major focus of the study was for those applicants closest to the boundary between the lower priced prime mortgage lending market and the higher priced subprime mortgage lending market, which, in addition to higher costs overall, exposes borrowers to greater risks of predatory lending. A large variance between scores on a consumer's file is a likely indication of drastically incomplete and/or incorrect information in that consumer's credit reports, and a cause for concern. For those closest to the boundary between prime and subprime, generally considered to be a credit score of 620, the impact of even small variances can be severe and translate directly into a greater financial burden.

Thus, more detailed information about each file was recorded: 1) if the file had widely varying scores among repositories (defined as a range of 50 points or greater between the high and low score); 2) if the file was near the threshold between prime and subprime classification with a substantial variance between scores (defined as having a middle score between 575 and 630, and a range between high and low scores greater than 30 points); or 3) if the file was directly at the threshold between prime and subprime classification (defined as having a high score above 620, and a low score below 620). For files that met these criteria, the four primary factors contributing to the credit score, provided by each repository as part of the credit report, were recorded.

Finally, if the file met criterion 2 (had a middle score between 575 and 630, and a range between high and low scores greater than 30 points), or if the file had a variation in scores of more than 90 points, the specifics of the three credit reports were reviewed in an attempt to identify any obvious inconsistencies between the repositories. When possible, researchers made a determination based on this review of whether any inconsistencies seemed likely to be artificially lowering or raising the score reported by one or more repositories.

B. Phase Two

The goal of Phase Two was to test the representational validity of the findings in Phase One by comparing key statistics from that sample of credit files with the same statistics for a much larger sample of credit files. Specifically, the goal was to compare the range among credit scores, and the frequency of explanations provided to consumers.

This phase of the study reviewed credit scores and the explanations for those scores provided by the repositories for a separate sample of 502,623 archived credit files. This larger sample was collected electronically and did not involve a manual review of each file. As with the first phase, these files had been requested by mortgage lenders on behalf of consumers actively seeking mortgages, and only credit files generated by a request for

¹⁸ Conducting and RMCR does not affect the credit scores, and when in depth reviews of the reports were conducted on RMCRs, the comments referred to the status of the report prior to updates or verification.

the reports and scores from all three major credit repositories (Experian, Equifax, and Trans Union) were included.

If a repository returned an unscored report, or if the repository could not locate a report for the applicant, this information was recorded. In addition, the presence of multiple reports from any repository and the scores for these reports, if scored, were recorded. For joint application files, the applicant's and coapplicant's reports were treated as separate reports.

For this phase of the study, the zip code for each file was recorded, as was information about the type of services requested for each file, and the version of the scoring model used to calculate each score. By matching zip codes with states, it was possible to determine the geography represented by these files. Phase Two analyzed files from every state and territory in the nation, with a wide distribution of files from all regions. (34% from the Northeast, 27% from the Southeast, 30% from the Midwest, 6% from the West¹⁹, 4% with no zip code information to indicate a state, and 0.08% from U.S. territories.)

Unlike the files in Phase One, which constitute a snapshot of the profile of consumers seeking mortgage credit over just several days, the files reviewed in Phase Two date from December 8, 2000 to September 20, 2002.

C. Phase Three

Phase Three explored the prevalence of specific errors in a representative sample of credit reports, and attempted to quantify how many files contained inconsistent, missing, or duplicated information. Researchers used a 10% sample of all files reviewed at one site in Phase One and reviewed account data and public records data for errors of omission (information not reported by all repositories) and errors of commission (inconsistent information between repositories, or duplicated information on a single repository).

This phase tabulated how many consumer files were missing accounts on at least one repository report that appeared on other repository reports, treating accounts of different type and status separately. The same criteria used to tabulate missing accounts were used to tabulate the number of files that contained duplicate reports of accounts on a single repository report.

¹⁹ The researchers were concerned that there were disproportionately fewer files from the western region, particularly a disproportionately low number of files from California. However, subsequent analysis showed that key statistics and distribution of score ranges for the files from this region, and from California specifically, were virtually identical to those for the entire sample. Therefore, the researchers are confident that this under-representation is not introducing any bias into the findings. (The regions were defined as follows Northeast: ME, NH, VT, NY, MA, CT, RI, PA, NJ, DE, DC, MD, WV, VA. Southeast: NC, SC, GA, TN, KY, AL, MS, FL, LA, AR, TX, OK. Midwest: OH, IN, IL, MI, WI, MN, ND, SD, IA, MO, NE, KS. West: AZ, NM, MT, WY, CO, UT, NV, CA, ID, OR, WA, AK, HI. Territories: GU, PR, VI.)

The seven types of accounts identified were mortgages, other installment loans, revolving accounts, other accounts not in collection, medical collections, child support collections, and other collections or charge offs. The researchers differentiated between the status of each non-collection account on the repository or repositories that did report the account. For accounts other than collections and charge offs (mortgages, other installment loans, revolving accounts, other accounts not in collection), the researchers differentiated between accounts that had no derogatory information, accounts that had late payments, accounts that had conflicting information regarding late payments on two repositories, and accounts that had inconsistent information regarding default. In addition, researchers noted if a mortgage had gone to foreclosure, and if a revolving account had been reported lost or stolen.

Files with duplicate or missing public records were tabulated, differentiating by type and status as well. Researchers tabulated missing and duplicate bankruptcy filings, liens, judgments, and civil suit filings, differentiating between two categories of status, those that had been filed, and those that had been recorded as released, satisfied, dismissed, or paid.

In addition to determining the number of files with missing and duplicate accounts, the researchers tabulated the number of files that contained certain inconsistencies between the three repositories regarding account details for accounts reported by all three. The inconsistencies of interest were: the number of payments recorded as 30 days late; the number of payments recorded as 60 days late; the number of payments recorded as 90 days late; the balance reported on revolving accounts or accounts in collection; the credit limit reported on revolving accounts; the past due amount; the method of payment (a code indicating if the account is currently being paid as agreed, is currently late, was late, but is now paid, etc.); the date of last activity on defaulted accounts; and the type of account. Finally, the researchers tabulated the number of files that reported a defaulted account, but did not report the date of last activity on that account.

VI. Findings

A. Phase One

1. Almost One in Ten Files was Missing a Credit Score from at Least One Repository.

Of the 1704 unique files reviewed, 1545 files had at least one score reported from each major credit repository. The remaining 159 reports were excluded from the statistical analysis because of one or more missing scores. Table 1 details the status of the files included and excluded from the analysis.

Table 1. Status of Files Reviewed in Phase One.

1390 Files with exactly 3 repositories scored, with no additional scores or unscored reports
114 Files with 3 repositories scored but with additional scores and unscored reports
41 Files with 3 repositories scored but with additional unscored reports
<hr/> 1545 Subtotal: number of files with 3 bureau scores -- included in analysis
58 Files with only 2 repositories scored*
26 Files with only 1 repository scored*
62 Files with no repositories scored*
13 Duplicate files, test files, or other errors that were thrown out
<hr/> 159 Subtotal: number of files excluded from analysis
<hr/> <hr/> 1704 Total Files Reviewed

* Unscored files include cases where no file was returned (no hit on information input during request) as well as cases for which a file was returned but not scored.

2. A Substantial Number of Files Met the Criteria for Further Review.

Of those 1545 files that had valid scores from each repository, 591 files, or 38%, were flagged for further review, based on the three predefined criteria outlined in the previous section and below.

Of the 1545 valid files:

1. 453 files, or 29%, had a range of 50 points or more between the highest and lowest scores.
2. 175 files, or 11%, had a middle score between 575 and 630 and had a range of 30 points or more between the highest and lowest scores.
3. 250 files, or 16%, had high scores above 620 and low scores below 620.

These numbers do not total 591 because many files met multiple criteria. Table 2 provides more detail on the number of files that met each of the criteria.

Table 2. Number of Files that met Criteria for Further Review in Phase One

Met Criterion 1	453
Met Criterion 1 only	273
Met Criteria 1 and 2 only	29
Met Criteria 1 and 3 only	79
Met all three Criteria	72
Met Criterion 2	175
Met Criterion 2 only	39
Met Criteria 1 and 2 only	29
Met Criteria 2 and 3 only	35
Met all three Criteria	72
Met Criterion 3	250
Met Criterion 3 only	64
Met Criteria 3 and 1 only	79
Met Criteria 3 and 2 only	35
Met all three Criteria	72
Met any of the three Criteria	591

3. Numerous Files Contained Additional Repository Reports and Information not Relevant to the Consumer’s Credit History.

Each file examined had been generated from a request for a merged file that included one report and one score from each repository. However, one in ten files (155 out of 1545) contained at least one, but as many as three, additional repository reports. These reports were not duplicate copies of reports, nor were they residual reports from previous applications for credit. These additional reports were returned from the same simultaneous request that produced the other reports in the file. For 114 of the files with additional reports, at least one, but as many as three of these additional reports also contained a credit score. It was unclear to researchers exactly how various systems would interpret these additional repository reports.

In some cases, an additional repository report was clearly reporting the credit activity of a separate person (no accounts from the additional report appeared on the three primary reports, and vice versa). However, it was very common for the additional report to contain a mixture of credit information, some of which belonged to the applicant and some of which clearly did not. In some cases, applicants had split files that appeared to be the result of applying for credit under variations of their name.

Common reasons for returning additional repository reports included:

- ? Confusion between generations with the same name (Jr., Sr., II, III, etc.).
- ? Mixed files with similar names, but different social security numbers.
- ? Mixed files with matching social security numbers, but different names.
- ? Mixed files that listed accounts recorded under the applicant’s name, but with the social security number of the co-applicant.
- ? Name variations that appeared to contain transposed first and middle names.
- ? Files that appeared to be tracking credit under an applicant’s nickname.
- ? Spelling errors in the name.
- ? Transposing digits in the social security number.
- ? An account reporting the consumer as deceased.

4. Scores Reported by the Three Repositories for a Given Consumer Varied Substantially.

The review found considerable variability among scores returned by the three credit repositories. Because the repositories all use the scoring model provided by Fair, Isaac, and Company, this considerable variability among scores suggests considerable differences in the information maintained by each repository. Fair, Isaac, and Company attribute variations in credit scores to variations in credit data²⁰. However, some have suggested that variations in credit scores may be occurring because not all data users are adopting new versions of the scoring model simultaneously. Researchers explored this concern using the data collected for Phase Two, and found the impact of different scoring models to be negligible.

Only one out of five files (328, or 21%) could be considered extremely consistent, with a range of fewer than 20 points between the highest and lowest scores. One in three files (475, or 31%) had a range of 50 points or greater between scores, and one in twenty files (81, or 5%) had a range of 100 points or greater between scores.

The average (mean) range between highest and lowest scores was 43 points, and the median range was 36 points. These statistics were reasonably consistent among the three regions²¹.

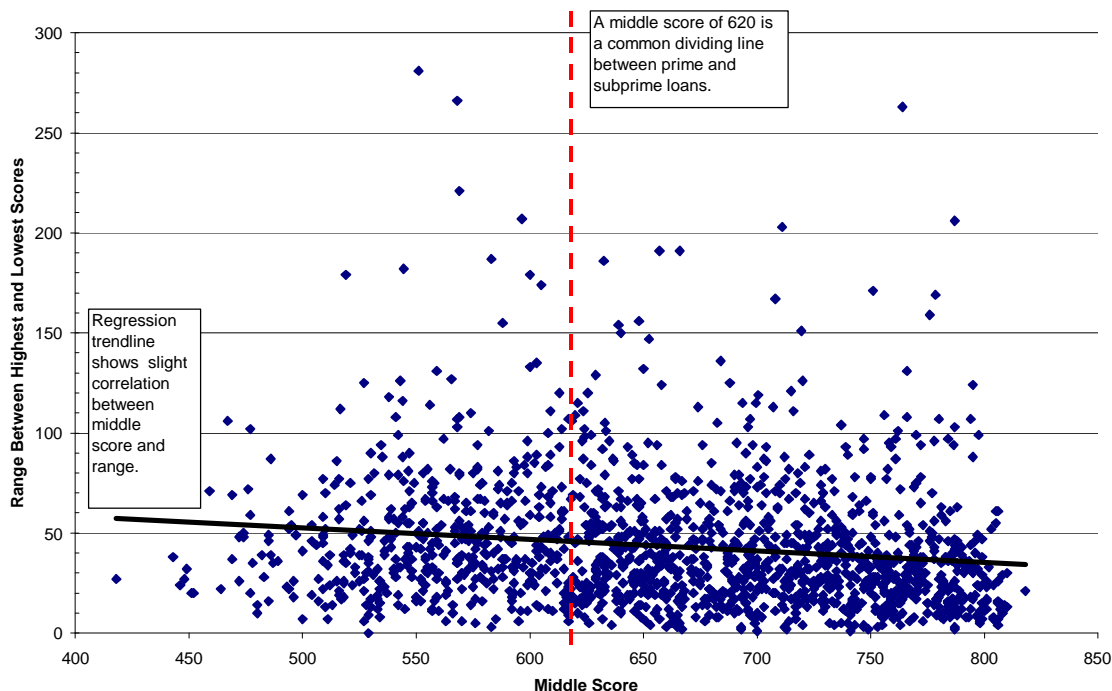
Files with good and bad credit both appear susceptible to large point ranges, although consumers with poor credit may be slightly more susceptible. Chart 1 compares the middle score of all files with the range between the highest and the lowest score for that file. The middle score is often the score used for loan approval. On this chart there is slight correlation between middle score and score variability. The regression trendline, which in this case estimates the average score range for each middle score, is relatively flat, but is higher for files with worse overall credit. This means that, on average, files with low middle scores have slightly greater variability among their scores, relative to files with high middle scores.

For example, for a middle score of 550, the regression line has a value of 50, meaning that the average range between high and low scores for files with a middle score of 550 is 50 points. In comparison, the average range between high and low scores for files with a middle score of 700 is 40 points. Thus, files with a middle score that is 150 points lower have an average score variability that is 10 points greater.

²⁰ Fair Isaac, and Company address the question of differing information at the three repositories as part of the explanation of how credit scoring works on their consumer oriented website, myFICO.com, stating: “Your score may be different at each of the three main credit reporting agencies: The FICO score from each credit reporting agency considers only the data in your credit report at that agency. If your current scores from the three credit reporting agencies are different, it’s probably because the information those agencies have on you differs.” (<http://www.myfico.com/myfico/CreditCentral/ScoringWorks.asp>)

²¹ In the Eastern region, the mean range was 40 and the median range was 33. In the Midwestern region, the mean range was 43 and the median range was 36. In the Western region, the mean range was 46 and the median range was 38.

Chart 1. Middle Score v. Range Between Scores



5. Reports Contained Limited Information to Help Consumers Understand the Principal Reasons for their Credit Scores.

If a consumer is subject to an adverse action because of information in a credit report, federal laws (the Fair Credit Reporting Act and the Equal Credit Opportunity Act) require the lender to make certain disclosures. Adverse actions include, among other things, denial of credit, or denial of favorable terms on credit. The required disclosures include statements that an adverse action has occurred and that the decision was based in part or entirely on a credit report and the specific, principal reasons for the adverse action (generally four reasons are given)²².

Thus, each repository report contains the four principal reasons contributing to the score returned, as identified by the automated process that calculated the score. The three repositories have approximately forty standard reasons that can be provided through this process. However, a mere four reasons were provided as the primary contributing reason on 82% of the reports reviewed (i.e. the reports in the 591 files that met any of the criteria for further review outlined in the study design). The four most frequently returned explanations for a consumer's score, with the frequency with which they occurred, were:

²² National Consumer Law Center, *Fair Credit Reporting Act, Fourth Edition*. 2000.

- ? “Serious delinquency, and derogatory public record or collection filed” (37% of all explanations).
- ? “Serious delinquency” (20% of all explanations).
- ? “Proportion of balances to credit limits is too high on bank revolving or other revolving accounts” (15% of all explanations).
- ? “Derogatory public record or collection filed” (10% of all explanations).

It is important to note that three of the explanations (“Serious delinquency,” “Derogatory public record or collection filed,” and “Serious delinquency, and derogatory public record or collection filed”) convey at least partially redundant information. These three explanations alone constituted 67% of all primary reasons provided.

6. In Depth Reviews Revealed Significant Errors and Inconsistencies, Some of Which were Likely Artificially Lowering Consumer Credit Scores, and Some of Which were Likely Artificially Raising Consumer Credit Scores.

In depth reviews were done of files that met the second criterion for further review (had a middle score between 575 and 630 and a range between high and low score of more than 30 points), or if the file had a range between scores of more than 90 points. In each case, researchers attempted to identify any obvious inconsistencies between the account level data on each of the repository reports, determine whether these inconsistencies were the result of omissions, or if they reflected conflicting credit data, and make a determination of whether the scores were likely being artificially inflated or artificially deflated by these inconsistencies.

There are obvious limitations to what the researchers could conclude during in depth reviews of credit file details without the aid of either creditors or consumers to corroborate or contest inconsistencies. The researchers attempted to approach these evaluations in as conservative a manner as possible; for example when derogatory information, such as a collection, was reported on only one repository, researchers tended to assume that the derogatory information was correct. However, when finer details were inconsistent, such as the current payment status of a given account, the more recent information was usually assumed to be correct. In total, 258 files were reviewed in depth.

For approximately half of the files reviewed in depth (146 files, or 57%), researchers were unable to identify clearly whether inconsistencies in the reports were resulting in an artificially higher or artificially lower score. In many cases this was because there were large numbers of derogatory accounts, reported in various combinations by one, two, or three of the credit repositories. For those files for which a determination was made, an even split existed between files for which one or two scores were likely artificially high (56 files, or 22%) and files for which one or two scores were likely artificially low (56 files, or 22%). Thus, at least one in five at risk borrowers, but likely many more, are likely being penalized because of an inaccurate credit report or credit score. Similarly, at least one in five at risk borrowers is likely benefiting from inflated scores because of

incomplete credit information. However, these figures are based on the assumption that, in the absence of contradictory information, all information that was reported by only one repository was accurate. The figures likely underestimate the actual number of borrowers who are at risk because they do not account for information that is simply incorrect, does not belong to the borrower, or has been contested and removed from one or two repositories, but not from all three.

While this finding suggests a certain statistical equilibrium between the harm and benefit that obvious omissions, mistakes, and inconsistencies may be causing to consumers on the macro level, credit scores are purported to offer consumer-specific evaluations, and are used to generate customer-specific prices and decisions. Lenders suffer little harm so long as there is such statistical equilibrium because the large number of consumers they serve allows them to benefit from the countervailing impact of these errors on a given pool of loans. Consumers, on the other hand, have one score for every purchase, and do not benefit from such statistical averaging. Given the number of decisions regarding access and pricing of essential services that rely on these scores, their determination should not be a lottery in which some consumers “win” because derogatory information is omitted while other consumers “lose” because erroneous, contradictory, outdated, or duplicated information is reported in their credit history. Rather, scores should be determined fairly and based on complete, current, and accurate information.

B. Phase Two

The second phase of the study examined the scores and primary factors contributing to the score, as identified by the repositories, from 502,623 files compiled from electronic records. Examining this very large sample allowed for a corroboration of some of the findings of Phase One among a larger population, roughly equivalent to a 0.25% sample, or one out of every 400 consumers with credit reports. Furthermore, because no details of the report were recorded beyond the credit scores and primary reasons for the scores, zip code data could be included without fear of recording excessive personal identifying information. This allowed for verification that the sample had broad geographical representation.

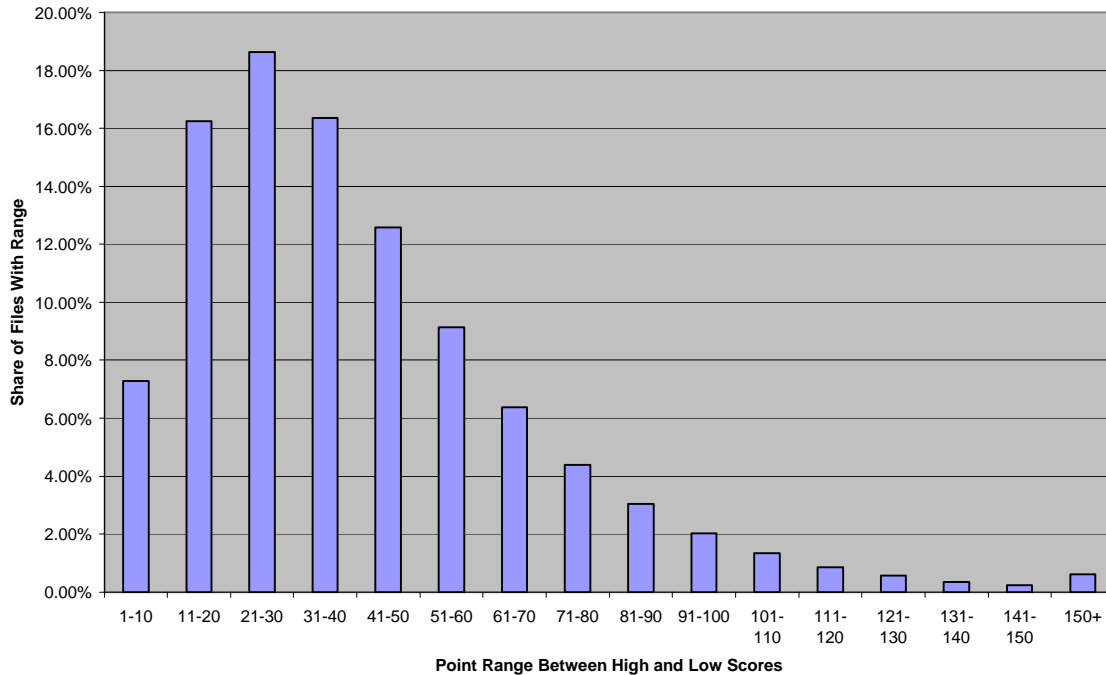
1. Scores Reported by the Three Repositories for a Given Consumer Varied Substantially.

The key findings from Phase Two are very similar to the findings from Phase One. Just fewer than one out of four files (105,324 files, or 24%, compared to 21% in Phase One) could be considered extremely consistent, with a range of 20 points or fewer between the highest and lowest scores. One in three files (129,284 files, or 29%, compared to 31% in Phase One) had a range of 50 points or greater between scores, and one in twenty-five files (17,626 files, or 4%, compared to 5% in Phase One) had a range of 100 points or greater between scores.

The average (mean) range between high and low score was 41 (compared to 43 in Phase One). The median range between high and low score was 35 (compared to 36 in Phase

One). Chart 2 is a histogram showing the share of files for which the range between highest and lowest score fell into 10 point bands up to 150, and the number of files for which the range exceeded 150.

Chart 2. Frequency of Ranges Between High and Low Score for Phase Two



2. Reports Scored With Different Versions of Scoring Software Reflected Almost No Difference in Overall Variability of Credit Scores.

As mentioned in the findings for Phase One, some have suggested that score variability can be explained by the fact that different versions of the Fair, Isaac, and Company scoring software may be in use in the marketplace as data users transition to a new version. The data collected in Phase Two allowed researchers to assess this and determine that the fact that reports were scored with different versions of the scoring models did not have an impact on the overall variability of credit scores in this study.

Fair, Isaac, and Company produces the software for all three repositories, but each repository refers to the scoring software by a different name. When Experian adopts a new version of the software, they discontinue the previous version (for example when they switched from a version Experian referred to as “Fair Isaac” to a version Experian referred to as “Experian/Fair Isaac Risk Model”), but users of Trans Union and Equifax software must update to the newest software version themselves, and there can be more than one version of the software in use at a given time. The sample examined in Phase Two reflected the use of two different versions of scoring software to score reports from Trans Union and Equifax. Trans Union reports were scored by an older version titled

“Empirica” and a newer version titled “New Empirica.” Equifax reports were scored by an older version titled “Beacon” and a newer version titled “Beacon 96²³.”

The use of different scoring models had a nearly imperceptible effect on variation among scores. Only three combinations of scoring models occurred in the sample. Reports scored with the two older versions, “Empirica” and “Beacon,” had an average range between the highest and lowest credit score of 39.61 points, and a median range of 33 points. Reports scored with “Empirica” and “Beacon 96” had an average range of 40.85 points, and a median range of 34 points. Reports scored with “New Empirica” and “Beacon 96” had an average range of 41.59 points, and a median range of 36 points. Comparing these statistics to the overall statistics for Phase Two (an average range of 41 points and median range of 35 points) shows that the influence of different scoring models is negligible, and if anything, the newer models resulted in a slightly greater variation among scores.

Recent commentary suggests that a new version of the software, “Next Generation FICO,” which Equifax will refer to as “Pinnacle,” Trans Union will refer to as “Precision” and Experian will refer to as “Experian/ Fair Isaac Advanced Risk Score,” may produce significantly different scores from earlier models, but has not been widely adopted in the marketplace²⁴. The impact of this new scoring tool is deserving of attention. However, none of the reports in this analysis were scored with this version of the scoring software.

3. Reports Contained Limited Information to Help Consumers Understand the Principal Reasons for their Credit Scores.

As in Phase One, a very limited number of standardized responses represented the vast majority of all explanations provided to consumers about their credit scores. The same four explanations that were predominant in Phase One were predominant in Phase Two, but in Phase Two a fifth code was returned with significant frequency.

Three explanations (“Serious delinquency,” “Derogatory public record or collection filed,” and “Serious delinquency, and derogatory public record or collection filed”) represented 50% of the primary explanations provided (compared to 67% in Phase One). The explanation “Proportion of balances to credit limits is too high on bank revolving or other revolving accounts” represented 18% of the primary explanations provided (compared to 15% in Phase One). While these explanations constituted a very large share of all the principal explanations (7 out of 10), a fifth explanation also constituted a significant share. The explanation “Length of time accounts have been established” represented 8% of all the primary explanations provided (compared to 5% in Phase One).

²³ In addition, 0.3% of files scored by TransUnion were scored by a version titled “Horizon,” approximately 6% of files scored by all three repositories did not identify the version of the software used for scoring, and an extremely small number of files (approximately 0.03%) were scored by a non-mortgage model, such as an auto model or a bankruptcy model.

²⁴ Harney, Ken. “Get Upgraded Credit Scoring,” Washington Post, November 23, 2002, and “Lenders Slow to Adopt New FICO Scoring Model,” Washington Post, November 30, 2002.

It is worth noting that the four principal reasons for credit scores were on every file included in the analysis in Phase Two, while Phase One only recorded the explanations for those that met the criteria for further review.

C. Phase Three – Specific Types of Errors

The dramatic ranges between credit scores uncovered in Phases One and Two seem to indicate wide ranging inconsistencies between the information on each repository for a given consumer. Phase Three attempted to quantify how many consumer files contain errors, and of what kind. Errors of omission (information not being reported by all repositories) and errors of commission (inconsistent information between repositories, or duplicated information on a single repository) were both considered. Researchers recorded how many consumer files contained at least one of each category of errors identified.

Phase Three re-examined a 10% randomly selected sample of the files reviewed at one of the sites from Phase One. In this sample of 51 three-repository merge files, errors of omission and commission were both rampant. Table 3 lists the categories of errors, the number of files that contained such errors, and the percentage of files that contained such errors.

This examination of the frequency with which certain errors occur is not intended to imply that the occurrence of any one of these errors alone will necessarily reclassify a consumer into a more expensive pricing class. The actual impact of any one of these errors will depend upon what other information exists in the consumer's credit report. Any error with the potential to lower a consumer's credit score will generally have a greater effect on "thinner" files, or files that have less information. Also, if a report has no derogatory entries, the first piece of derogatory information will very likely have a more severe negative impact on a consumer's apparent creditworthiness than the same information would have on a file with multiple derogatory entries. However, it is possible for a single derogatory entry to have a dramatic effect on a consumer's score, whether or not it is accurate. If that consumer is near the threshold for a less favorable pricing class, it is very possible and probable that an error or errors in that consumer's credit history could have a substantial material impact. Furthermore, most reports reviewed contained more than a single error, and the cumulative effect of multiple errors increases the likelihood of material impact on consumers.

The sample size in Phase Three is the smallest of the three phases, due primarily to the time required to review files in sufficient depth to identify specific errors. The researchers recognize that the statistics from this phase have limitations and it is difficult to make definitive statements about the frequencies with which specific errors occur in the population at large based on these findings. However, this phase does document strikingly high levels of errors and provides evidence that at the very least a significant minority in the general population are at risk for a variety of errors of commission and omission.

Table 3. Types of Errors, and Number and Percentage of Files Containing Such Errors

Type of Account	Status	Omission		Commission			
		Number of Files Missing Such Acct.	% of Files Missing Such Acct.	Number of Files with Such Acct. Duplicated	% of Files with Such Acct. Duplicated	Number of Files with Inconsistent Info	% of files with Inconsistent Info
Mortgage	No Derogatory Info	17	33.3%	1	2.0%		
Mortgage	Late Payments	1	2.0%		0.0%		
Mortgage	Inconsistent Lates btw Repositories	1	2.0%		0.0%		
Mortgage	Inconsistent, one shows Default		0.0%		0.0%		
Mortgage	Foreclosure	2	3.9%	1	2.0%		
Other Installment	No Derogatory Info	34	66.7%	4	7.8%		
Other Installment	Late Payments	3	5.9%		0.0%		
Other Installment	Inconsistent Lates btw Repositories	2	3.9%	1	2.0%		
Other Installment	Inconsistent, one shows Default	1	2.0%		0.0%		
Revolving	No Derogatory Info	40	78.4%	9	17.6%		
Revolving	Late Payments	6	11.8%		0.0%		
Revolving	Inconsistent Lates	2	3.9%		0.0%		
Revolving	Inconsistent, one shows Default	4	7.8%		0.0%		
Revolving	Missing Lost or Stolen	8	15.7%		0.0%		
Other	No Derogatory Info	8	15.7%	1	2.0%		
Other	Late Payments		0.0%		0.0%		
Other	Inconsistent Lates btw Repositories		0.0%		0.0%		
Other	Inconsistent, one shows Default		0.0%		0.0%		
Collection Medical	Collection/ Chargeoff	10	19.6%		0.0%		
Collection Child Support	Collection/ Chargeoff	1	2.0%		0.0%		
Other Collection or Chargeoff	Collection/ Chargeoff	13	25.5%	3	5.9%		
Bankruptcy	Filed		0.0%		0.0%		
Bankruptcy	Released/Satisfied/Dismissed/Paid	5	9.8%	1	2.0%		
Lien	Filed	4	7.8%		0.0%		
Lien	Released/Satisfied/Dismissed/Paid	2	3.9%		0.0%		
Judgement	Filed	3	5.9%		0.0%		
Judgement	Released/Satisfied/Dismissed/Paid	2	3.9%		0.0%		
Civil Suit	Filed		0.0%		0.0%		
Civil Suit	Dismissed	1	2.0%		0.0%		
	# 30 Late					22	43.1%
	# 60 Late					15	29.4%
	# 90 Late					12	23.5%
	Balance on Revolving Accts or Collections					42	82.4%
	Credit Limit on Revolving Accts					49	96.1%
	Past Due Amount					9	17.6%
	Current Method of Payment					31	60.8%
	Type of Account					11	21.6%
	Last Activity on Defaulted					13	25.5%
	No Last Activity Date on defaulted accounts	11	21.6%				

1. Significance and Frequency of Errors of Omission

Incomplete reporting of information, or an error of omission, can make a consumer appear either more credit worthy or less credit worthy, depending on the nature of the information that is omitted. When a derogatory account, such as a collection, late payment, charge off, or public record is omitted, the consumer's record will appear less risky, and the consumer's credit score will likely be artificially high. However, when a positive account, such as a mortgage, auto loan, or credit card account that has been paid as agreed, is omitted, this responsible credit behavior will not be conveyed and the consumer's credit score will likely be artificially low.

Positive account information is especially important for consumers who are just beginning to establish credit, or who are working to re-establish their credit rating after bankruptcy. Omitting positive information can have a dramatically negative impact on such consumers. Failure to report positive accounts can deflate scores, or even make it impossible for the scoring model to produce a score. Such outcomes make it more difficult to enter or return to the prime lending marketplace, relegating affected consumers to the higher priced subprime market.

Because of the limitations of the study, researchers were unable to determine definitively whether many of these errors were errors of omission. For example, researchers could not be certain that accounts appearing on one report only were the result of omissions by the other two repositories, or if the accounts appeared as the result of merging errors, or compiling errors on that one repository (and actually did not belong to the consumer), or if they had been contested and removed from some repositories but not removed from all three. In the absence of evidence that presented a contradiction, researchers conservatively treated information appearing only on one or two repositories as an error of omission.

a) More Files Contained Omissions of Positive Information than Contained Omissions of Derogatory Information, but Omissions of All Kinds were Common.

Accounts that had never been late, and which have great significance for determining a credit score, were omitted with extremely high frequency. Omitted revolving accounts with no derogatory information were noted on the largest number of consumer files. Nearly eight out of ten files (78.4%) were missing a revolving account in good standing. In addition, one file out of three (33.3%) was missing a mortgage account that had never been late, and two files out of three (66.7%) were missing another type of installment account that had never been paid late. Other accounts with no derogatory information, such as non-revolving credit cards, were missing on 15.7% of all files.

Omissions of accounts with late payments, but which had not been sent to collection, were less frequent than omissions of positive accounts. Still, one in ten files (11.8%),

was missing a revolving account with late payments reported, and many (7.8%) were missing revolving accounts that were being reported as defaulted by one of the two repositories that reported the account. Half that number (3.9%) contained conflicting information about late payments on revolving accounts reported by two repositories. A much smaller number of files were missing mortgages or installment accounts that had been late at some time in the past, or that had conflicting information regarding late payments, but 3.9% of files omitted a foreclosure.

The most commonly omitted derogatory information was for various types of collections. Child support collection omissions were rare (2% of files), but one out of five files (19.6%) omitted a medical collection, and one out of four files (25.5%) omitted a collection of some other kind.

b) Medical Collections Raise Special Concerns Regarding Appropriateness and Privacy.

Medical collections, as a subset of collections that were often not reported on all three repositories, deserve special attention. Disputes between consumers, health insurance companies, and medical care providers occur frequently, and can be of extended duration. Many medical bills are referred to collection agencies during these disputes but are ultimately paid by insurers. Therefore, if all the relevant facts were known these collections could very likely be errors of commission, rather than errors of omission, as they may not accurately reflect consumer debt repayment behavior.

Another issue noted by researchers related to medical collections was the high degree of information that can be inferred from the information in medical collection entries listed on a consumer's credit report. The names of many medical creditors are specific enough to allow for identification of categories of treatment. For example, information in collection entries identified categories of medicine, such as perinatology, and neonatal health clinics. This could have especially significant ramifications if full credit reports are reviewed by potential and current employers, who may infer from such collections that an applicant, or employee, has an unusually sick newborn, and may be more likely to be called away from the office²⁵. In other cases, consumers may simply wish not to have the fact that they have sought treatment for other very private matters (such as treatments for fertility, mental health, or AIDS) to be readily discernible by anyone who reviews their credit record.

Section 604 (g) of the Fair Credit Reporting Act states that "A consumer reporting agency shall not furnish for employment purposes, or in connection with a credit or insurance transaction, a consumer report that contains medical information about a consumer, unless the consumer consents to the furnishing of the report." However, consumers have complained about the difficulty of identifying the original creditors for collection accounts that appear on their files, and best practices have been proposed by

²⁵ It is the researchers' understanding that current market practices do not permit employers to view the same level of detail that is provided to potential lenders. Employer credit reports generally do not contain the notations on collection entries that would allow them to make such medical inferences.

the Consumer Data Industry Association that attempt to strike a balance between protecting consumers' medical information and providing enough information to allow consumers to identify the original source of debts. Furthermore, it is the Researchers' understanding that in Massachusetts, the original creditor must be listed for every collection account.

c) Public Record Information was Frequently Omitted, Including Both Information that Would Likely Increase Credit Scores and Information that Would Likely Decrease Scores.

One in ten files had an omitted date of fulfillment for a bankruptcy, an omission that almost certainly lowered the corresponding credit scores. Several files also contained reports that omitted liens, both satisfied (3.9%) and unsatisfied (7.8%), and judgments, both satisfied (3.9%) and unsatisfied (5.9%). One file contained a dismissed civil law suit that was reported to one repository only.

Given the dramatic frequency of omissions of both positive information (such as mortgages) and derogatory information (such as collections and public records) it is clear that errors of omission have the potential to undermine the accuracy of consumer credit records and, by extension, credit scores. It should be noted that true errors of omission (excluding unrelated account information that is erroneously captured by one repository and disputes which have not resulted in removal of information from all three repositories) are most likely the fault of the creditor, not the credit repository. If a data provider, be it a collection agency or major national bank credit card, decides not to report information to all three repositories, then the repositories do not know the information and cannot report it.

2. Errors of Commission

Also of great concern to consumers is the frequency with which errors of commission, or inclusion of incorrect information, occur in credit reports. A credit report with incorrect derogatory information makes a consumer appear to be a greater lending risk and will likely artificially lower the consumer's credit score. In addition, duplicate reporting of accounts can have an impact on a consumer's scores.

Again, because the researchers did not have the benefit of knowing the consumers' credit histories, we were limited in the errors of commission that we could identify. Only in cases where repositories were reporting conflicting details on an account could researchers identify with certainty that at least one repository was incorrect. Even with these limitations, the findings are troubling.

a) Many Consumer Files Contained Conflicting Information Regarding the Consumer's Record of Late Payments.

In 43.1% of the files, reports regarding the same accounts conflicted regarding how often the consumer had been late by 30 days. In nearly one out of three cases (29.4%), there

was conflicting information about how many times the consumer had been 60 days late, and conflicting information regarding the number of times an account had gone to 90 days late in one out of four consumer files (23.5%). Late payments, especially on recent accounts, can be very detrimental to a consumer's credit score. Delinquencies are identified as major contributing reasons for a consumer's score on the majority of reports.

In some cases, but by no means in all, different numbers of late payments may be the result of the timing of record updating procedures by the repositories. For example, one repository may have information on an account that is current as of June, whereas another repository may only have received or loaded information current as of May. However, this phenomenon would only explain variations for accounts that are currently past due, and not for the significant number of files that were currently reported as paid on time, but had discrepancies in the historical count of late payments. Furthermore, regardless of a repository's particular timing, a consumer will be evaluated on the information available at the time of application.

b) Reporting of Account Balances was Inconsistent

Inconsistencies regarding the balance on revolving accounts or collections appeared on 82.4% of files, and inconsistencies regarding an account's credit limit appeared on 96.1% of files. These particular numbers are presented with one qualification. The software used to review reports presents information in a field titled "credit limit/high credit." Researchers acknowledge that the raw data may contain separate information regarding the high credit (the highest amount ever charged on this account) and the credit limit (the amount of credit made available by the creditor) and the observations regarding inaccuracies in these fields may not reflect the data used to derive credit scores. However, even with this qualification, there are reasons to be concerned about incorrect reporting of balances or credit limits. Credit card lenders have an incentive to obscure the real credit limit from credit reports, as a means of retaining existing borrowers. If a credit card lender reports a credit limit as lower than the actual limit (for example by reporting the high credit as the credit limit) the borrower will appear to be closer to "maxing-out" their credit, and will appear less attractive to competing credit card lenders. Thus, the consumer will be less likely to receive competing offers. Such misreporting also poses a significant risk to consumers' overall credit rating. The practice of deliberately refusing to report complete and accurate account information in order to obscure consumers' credit has drawn repeated condemnation from John Hawke, the Comptroller of the Currency²⁶. There is good reason to be concerned, given that one of

²⁶ In a May 5, 1999 speech before Neighborhood Housing Services of New York, Hawke stated, "Subprime loans can't become a vehicle for upward mobility if creditors in the broader credit market lack access to consumer credit history. Yet, a growing number of subprime lenders have adopted a policy of refusing to report credit line and loan payment information to the credit bureaus – without letting borrowers know about it. Some make no bones about their motives: good customers that pay subprime rates are too valuable to lose to their competitors. So they try to keep the identity and history of these customers a closely guarded secret" (<http://www.occ.treas.gov/ftp/release/99-41a.doc>). He reiterated these concerns in a June 9, 1999 speech before the Consumer Bankers Association, condemning the objectionable practice of non-reporting and noting that, "failure to report may not be explicitly illegal. But it can readily be

the most frequently provided explanations for a consumer's credit score is that the "proportion of balances to credit limits is too high on bank revolving or other revolving accounts." This is the primary explanation listed on approximately one out of six reports.

c) Contradictory or Missing Dates Occurred Frequently and Have the Potential to Distort a Consumer's Record.

Because more recent credit activity is more influential in determining a credit score, it is important that the relevant dates on accounts be accurate. This is primarily true for accounts that have gone into default. Creditors track the date of last activity on consumer accounts, but, because most creditors report to repositories in large batches of data on many accounts, credit repositories also track a second date – the last date the information was reported by the data provider. If a data provider fails to report any information in the date of last activity data field, the scoring software will assume that the date last reported is the date of last activity. Thus, if a consumer has an account that defaulted several years ago, but otherwise has good credit, under normal circumstances the relative impact of this account will diminish over time. However, if there is no date of last activity reported, this default will seem perpetually as recent as the last submission of a batch of data from that provider. One in five consumer files (21.6%) contained a defaulted account that did not report a date of last activity. One in four files (25.5%) contained contradictory information regarding the date of last activity.

d) Duplicate Reporting of Accounts did not Appear to be as Widespread as Many of the Other Errors Noted in this Investigation.

When accounts were reported multiple times by a single credit repository, they tended to be accounts that had no derogatory information, which may provide an artificial boost to a consumer's credit scores by giving the impression that the consumer has successfully managed more credit than he or she actually has, but may also lower a consumer's credit score by increasing their apparent overall debt load. Also, on 5.9% of files a collection was reported more than once on a single credit report, likely artificially lowering the score. This was usually the result of a collection being reported by the original creditor as well as a collection agency that had taken over the account.

Further contradictions existed regarding the method of payment (whether an account was current, late, charged off, in collection, etc.) on 60.8% of files, the type of account (revolving, installment, mortgage) on 21.6% of files, and the past due amount on 17.6% of files.

3. Merging and Compilation Errors

Credit data are complex, and accurate interpretation of it can sometimes take a considerable amount of time and effort. When credit reporting agencies and credit users

characterized as unfair; it may well be deceptive, and – in any context – it's abusive" (<http://www.occ.treas.gov/ftp/release/99-51a.doc>).

review merged reports, they employ software to help organize and simplify the information, so the user can quickly assess the unique information contained in each repository without having to sift through the same information reported by another repository. The design of a tool to do such work involves making certain choices, which can lead to significantly different results. For example, some merging software is designed to present the details for a given account from one of the three repositories to a credit user, and “hide” the other two repositories reports. Other software utilizes a merging logic that takes some information from each repository report to create an amalgam of the information in each credit report. This one example of a design decision can result in a very different presentation of the same raw data to a credit reporting agency or credit user.

The discussion of duplicate and mixed files in Phase One already illustrated that a large number of errors enter the credit reporting system when the automated software used by the credit repositories compiles information about credit users. Use of nicknames, misspellings, transposed social security numbers, and mixed files that report information under one person’s name, but match that name to a spouse’s social security number, are all examples of variations that can result from an automated interpretation of complex and sometimes contradictory personal identifying data. Software designers must make explicit choices about how to interpret this data, and what form the output will take. For one in ten files, the result was an additional repository report and/or an additional credit score.

A similar potential for error exists when automated systems interpret multiple reports, merging the three credit reports into a single representative report. This process attempts to reconcile the voluminous inconsistencies between repositories for account level information. Given the difficulties that are apparent from the attempts to reconcile individual consumer information, the importance of ensuring a fair and rigorous merging logic for any compilation software is clear.

These concerns raise many questions. How exactly does a software program that collects information from multiple credit repositories interpret conflicting or duplicated information? How much variation can a given software package consider before an account entry is treated as a separate account? How many creditors are trying to game the marketplace by not reporting complete or accurate information about consumers – in effect making consumers appear less creditworthy than they actually are to other potential creditors, in a bid to protect their customer base?

We do not raise these problems to advocate an end to use of multiple repository reports. In fact, use of multiple credit scores serves as a control against errors of omission. (All of the errors of omission identified in this study were identified because of the use of multiple repository reports.) On the contrary, we identify these problems to illustrate that there are difficult choices that must be made when developing all of the components of the interconnected system that evaluates credit. Given the lack of oversight of this dimension of the market, there is a very real potential for developers to make choices that

result in a system that is unfair to consumers in general or to a certain segment of consumers, such as those nearest the threshold between prime and subprime.

VII. Conclusions and Implications of the Findings for Consumers

A. Credit scores and the information in credit reports vary significantly among repositories.

The scores based on data from the three repositories can vary dramatically for all consumers regardless of whether they have generally good or bad credit histories. Approximately one out of every three files (31%) had a range of 50 points or greater, and one out of twenty reports had a range of 100 points or greater (5%). The average range between high and low scores was 43 points (median range was 36).

The wide range in credit scores reflects a similarly broad variation in the data contained in each repository report for a given consumer. Significant accounts, such as mortgages, credit cards, collections, and public records, were regularly omitted from one or more credit repository reports. In addition, for most consumers, the details of accounts that are reported by all three repositories are unlikely to be completely consistent. Information about late payments, the balance and credit limit on revolving accounts, and the current status of accounts are among errors that occur frequently.

B. Many consumers are unharmed by these variations, and some probably benefit from them.

Consumers with very good credit histories, whose credit scores place them firmly above the cutoff for the most favorable product terms, are as likely as any other consumer to have variation between credit scores. However, as long as that variation does not result in scores that are lower than the qualifying score for the best terms for credit, insurance, or any other product or service underwritten by their credit score, there will be no material harm. The number of consumers in this category is somewhat unclear and depends upon the products being sought and the qualifying scores for those products.

Furthermore, those near the boundary between pricing ranges, such as the division between the prime and subprime mortgage markets, who have errors that artificially raise their scores may be artificially classified as lower risk. As a result, such consumers have the potential to reap some benefit from the inconsistencies.

C. However, tens of millions of consumers are at risk of being penalized for incorrect information in their credit report, in the form of increased costs or decreased access to credit and vital services.

We estimate that tens of millions of consumers are at risk of being penalized by inaccurate credit report information and incorrect credit scores. Between 190 and 200 million Americans, or nearly every adult consumer, has a credit report that can be scored to produce a credit score. Businesses from mortgage lenders to utility providers increasingly have established pricing structures in which the charge for the loan or service corresponds to a credit score range. Errors in credit reports that lower a consumer's credit score can place that consumer into a more expensive pricing range than

he or she deserves to be in. Credit scores below a certain cutoff point can even disqualify consumers outright.

Looking at the mortgage market as an example, the two most significant ranges are defined by a credit score of 620. Whether a consumer's credit score is above 620 or below 620 determines if the consumer qualifies for²⁷ the lower priced prime market, or if the consumer will be limited to subprime market, which imposes higher borrowing costs, often requires larger down payments, and exposes consumers to abusive predatory lending practices. In addition to this primary division in the prime and subprime mortgage markets, there are secondary pricing ranges. According to the consumer focused website of Fair, Isaac, and Company (www.myfico.com), consumers with a score between 720 and 850 will qualify for the lowest interest rates, but there are at least four different pricing ranges in the prime market and at least two in the subprime market. Consumers with a score between 700 and 719 will be charged higher borrowing costs than those in the highest score range. Prices similarly increase for scores between 675 and 699, and between 620 and 674. Within the subprime market, the two pricing ranges identified by Fair, Isaac, and Company are from 560 to 619 and from 500 to 559.

This study focused on consumers at risk for misclassification into the subprime market due to inaccurate information in their credit report and found that one in five consumers (20.5%) is at risk. We have defined at risk consumers as either having a middle credit score between 575 and 630 with a score variance of greater than 30 points, or as having a high score above 620 and a low score below 620. Among these at risk consumers, based on our analysis of files, we estimate that at least one in five (22%) is likely being penalized with lower scores than deserved because of errors or inconsistencies in his or her credit report that are clear enough to be noticed by an outside observer unfamiliar with that consumer's debt payment history. (We also estimate that at least one in five (22%) has scores that are likely too high due to a lack of reporting by creditors to all repositories.) The remaining sixty percent of at risk consumers have credit reports without errors clear enough to allow an outside observer to determine whether their credit scores are artificially low or artificially high. We strongly suspect that a significant share of these at risk consumers also have artificially low credit scores due to errors in their reports that they would be able to identify if given the opportunity.

While the findings suggest that there may be some statistical equilibrium between those consumers who have artificially high scores and those who have artificially low scores, such statistical averaging is irrelevant to the individual consumer who is penalized based on errors in his or her credit report. Credit scores are purported to offer consumer specific evaluations of credit and do result in consumers specific decisions regarding pricing and availability for the essentials of daily life and economic activity.

Consumers may be harmed by both errors of commission and errors of omission. Errors of commission can lower a consumer's score in situations such as when incorrect

²⁷ Because of the aggressive sales tactics of subprime and predatory lenders, many consumers who have credit scores above 620 have subprime loans, although they could have qualified for less expensive prime loans. This is an important but separate issue.

information or mixed files add the credit history of others to a consumer's report. Errors of omission can lower a consumer's score when the record does not contain full and accurate information regarding existing accounts paid as agreed.

Those consumers on the threshold of subprime status face particularly dire consequences from this lack of precision. Falling below the cutoff score for a prime rate mortgage can add a tremendous financial burden to these threshold consumers and make it more difficult to meet this and other financial obligations. Interest rates on loans with an "A-" designation, the designation for subprime loans just below prime cutoff, can be more than 3.25% higher than prime loans. Thus, over the life of a 30 year, \$150,000 mortgage²⁸, a borrower who is incorrectly placed into a 9.84% "A-" loan would pay \$317,516.53 in interest, compared to \$193,450.30 in interest payments if that borrower obtained a 6.56% prime loan – a difference of \$124,066.23 in interest payments²⁹.

We conservatively estimate that 40 million consumers (twenty percent of the 200 million with credit reports) are at risk of being misclassified into the subprime mortgage market, and at least 8 million (twenty percent of these at risk consumers) would be misclassified as subprime upon application, but the actual numbers are likely much higher. These numbers do not even attempt to quantify the number of consumers who are being overcharged because errors pushed them into a higher pricing range within the prime or subprime markets. Furthermore, consumers with errors in their credit reports and artificially low credit scores are penalized in a number of markets in addition to the mortgage market. These figures do not address the consumers penalized with higher credit card interest rates, more expensive insurance, or those denied insurance, housing, utility service, or employment (an application of credit scoring we expect to increase in frequency) on the basis of erroneous credit scores.

D. Almost one in ten consumers runs the risk of being excluded from the credit marketplace altogether because of incomplete records, duplicate reports, and mixed files.

If a consumer has very little credit history, or is rebuilding credit after a bankruptcy, every positive account that they can establish is vital for creating a record that has sufficient information to be scored. If a lender requests scores for a consumer, but a repository is unable to return a score (as was the case for approximately one out of ten files reviewed in this study), that lender may choose to set aside the customer's application and focus on an application with enough credit to be scored and priced with minimal work. This is especially likely during periods of heavy volume, such as the prolonged refinancing boom currently occurring. Even if a lender later returns to the file that was set aside once volumes have subsided (perhaps because of seasonal fluctuations in home buying activity, or because interest rates have risen), the consumer will have suffered substantial harm by being excluded even temporarily from the marketplace.

²⁸ The Federal Housing Finance Board's *Monthly Interest Rate Survey* reports that the national average loan amount for conventional home purchase loans closed during June of 2001 was \$151,000.

²⁹ Interest rates as reported by *Inside B & C Lending* for 30 year Fixed Rate Mortgages for "A-" Credit (par pricing), and "A" Credit respectively, as of July 14.

Consumers may not understand the implications of incomplete reporting or non-reporting by their creditors, and would have little leverage to force their creditors to report up to date information anyway.

Similarly, consumers generally have no control over the inclusion in their credit files of duplicate reports, or mixed information not belonging to them. The only person in a position to tell if a credit repository's compilation system incorrectly groups unconnected information with a consumer, or to assess why their credit record was not scored, is the lender. But there is no requirement that the lender share the report or score with the consumer. Furthermore, if the lender incorrectly enters the identifying information, during a credit review, either leaving out information such as social security number, generation (Jr., Sr., etc.), or mistyping the applicant's name or other information, the lender may be contributing to the problem. If a consumer later requests a copy of his or her credit file after denial, he or she will often be required to provide more comprehensive information than the original data user. This means that the report eventually provided to the consumer may have a lower propensity of errors than the version used to evaluate his or her application. This is especially true for non-mortgage credit, or mortgage credit underwritten with files ordered directly from one or more credit repositories. If a mortgage lender ordered a merged credit report from a credit reporting agency that merged the files into a new report, and after being denied the borrower requests a copy of the credit report from that agency, the agency has an obligation to give the consumer the merged credit report.

The treatment of unscored files is a very serious question. How do automated credit reviews treat files that contain extra scores, or extra reports that are unscored? One in ten requests fails to return a score from each repository. As many requests return one score from each repository, but also return additional files that may or may not be scored. If automated credit reviews reject additional files, as many as two in ten consumers could be excluded from the credit market outright because of these problems.

E. The use of information from all three repositories in mortgage lending protects consumers and creditors from being negatively affected by errors of omission, but it may increase the negative impact on consumers of errors of commission.

The use of information from all three repositories on mortgage underwriting offers consumers and creditors protection against errors of omission by introducing the maximum available information to the scoring and underwriting process. However, errors of commission actually occur on more files than do errors of omission, and there are a number of different approaches to using information from three repositories for underwriting purposes. Without a chance for borrowers to review their reports for errors of commission at the time of underwriting, and without oversight of how the information is merged and presented, the use of multiple repository sources of data can produce a result that is harmful to consumers.

F. Consumers are not given useful and timely information about their credit.

1. Standardized, generic explanations do not provide sufficient information for consumers to address inconsistencies and contradictions, let alone outright errors.

Approximately 7 in 10 credit reports indicated that the primary factor contributing to the score was “serious delinquency, derogatory public record, or collection filed,” or some subset or combination of these factors, without providing any information about which specific accounts were responsible for the low scores. In many cases, it is not even clear whether a delinquency, public record, or collection was responsible for the score. In addition approximately one in six reports indicated that the primary reason for the score was that the proportion of revolving balances to revolving credit limits was too high. These two relatively generic explanations were reported as the primary reason for a derogatory score on more than 8 out of 10 reports reviewed.

The vague information provided by these explanations is too general to be helpful. Nearly all consumers near the subprime border have had some activity in their past that may fall under the broad terminology “serious delinquency, derogatory public record, or collection filed,” almost by definition. If their credit records were more favorable, they would not be so close to the subprime threshold. Such borrowers may accept this generic justification for a low score more readily than consumers with generally good credit. Thus, the consumers who are most likely to be penalized by errors are the least likely to challenge these imprecise explanations. Because threshold consumers are not provided the specific account information that is lowering their scores, they are not given the tools to identify and correct possible errors. The situation would likely be different if consumers had access to the full credit reports and scores used to underwrite their loan applications, with an indication of which accounts had the largest negative effect on their scores. If this were the case, consumers would have a much more legitimate opportunity to identify and challenge any errors.

The credit report is a rare type of consumer product. Consumers pay for it during mortgage underwriting, and are rewarded or penalized on the basis of it, but are not even allowed to look at it, much less keep a copy for their records. Furthermore, consumers can understandably view the report as “theirs” because it is purportedly a record of their behavior.

2. Consumers outside of California have no affirmative right to know their credit scores.

Credit scoring is a shorthand that allows lenders to more quickly assess the complex information in a consumer credit report. However, with the exception of California residents, consumers are not guaranteed access to their credit scores, although they are permitted to purchase copies of the underlying data. Thus, consumers are placed at a disadvantage relative to lenders when it comes to evaluating their own credit-worthiness. When Californians gained access to their scores, many lenders across the country did

begin making the scores available. As with the specific credit report used to evaluate an application, consumers are charged for the additional cost of obtaining a credit score for underwriting, but have no guarantee that they will be able to view the specific score used to underwrite their loan. Currently, all three repositories allow consumers to purchase scores in conjunction with credit reports, but prior to the passage of the California law requiring this, the repositories resisted providing scores to consumers.

G. Private companies without significant oversight are setting, or at the very least heavily influencing, the rules of the marketplace for essential consumer services that base decisions on credit scores.

Companies, such as Fair, Isaac, and Company, have produced credit scoring software that is increasingly used in the marketplace to determine access and pricing for the essentials of daily life and economic activity. Consumers have no choice regarding how lenders or other data users evaluate their credit, and widespread and increasing use of credit scoring systems that evaluate applications for credit, mortgages, insurance, tenancy and even employment is a fact of the marketplace. Scoring systems incorporate many complex decisions regarding the interpretation and treatment of information that can be contradictory, incomplete, duplicative, or erroneous. There is great potential for these systems to incorporate inappropriate decisions that result in consumer harm, especially as models originally designed to evaluate credit applications are adapted to evaluate applications for services completely unrelated to credit behavior.

Despite the tremendous and growing influence of automated credit evaluations, no government entity has recognized and acted on the clear need for ongoing, timely review of these software systems to determine their accuracy, fairness and appropriate application. Many decision-makers who use scoring systems to evaluate consumer applications do not even understand the systems themselves and cannot explain them to consumers. Thus, while decision-makers are increasingly relying on programs that they do not understand, no public entity is guaranteeing the validity and fairness of such programs. Without independent review and oversight of this market force, consumers are, literally, left to the devices of the system developers.

H. Certain information in credit reports has the potential to cause breaches of consumers' medical privacy.

Many credit report entries regarding medical collections contained enough information to infer medical details about consumers, such as the type of treatment they had received. The ability to discern from a credit report that a consumer may have received treatment from a neonatal clinic, a fertility clinic, a mental health provider, or an AIDS clinic has serious implications for medical privacy, and could potentially facilitate discriminatory treatment. While section 604 (g) of the Fair Credit Reporting Act prohibits furnishing of medical data in connection with employment, credit, or insurance transactions, consumers also complain that reporting collection accounts without identifying the original creditor makes it difficult for consumers to decipher their own reports. It is the understanding of researchers that current market practices limit the level of detail in

reports provided to employers, aggregating information in such a way that individual creditors are not identified, and an employer would be unlikely to be able to make specific inferences about an applicant's or employee's medical condition. Nonetheless, the presence of this information among the data held at the repository level is troubling and deserving of further attention.

VIII. How to Improve the System

A. Require creditors to immediately provide to any consumer who experiences an adverse action as a result of their credit reports or credit scores a copy of the credit reports and scores used to arrive at that decision free of charge and permit disputes to be immediately resubmitted for reconsideration.

All consumers who experience an adverse action based on one or more credit reports or scores (such as having a loan or insurance application denied, being charged higher than prime rates, or receiving less favorable terms) should immediately be given a copy of both the full report or reports used to derive that score and the related credit scores without having to pay any additional fee. These reports should identify any entries that are lowering the consumer's score and indicate the impact (either the point value deducted for that entry or the proportional impact of that entry relative to other derogatory entries in the report). The consumer should then be allowed to identify any errors or out of date information, provide documentation, and be reevaluated for prime rates.

The additional cost to lenders and businesses of providing these reports immediately would be minimal. Since they already possess the report in paper or electronic form, they would merely have to copy or print this report.

Simply providing consumers with the name and contact information of the consumer reporting agency or agencies that provided the information used to arrive at the decision is insufficient because it creates an unnecessary obstacle and, especially for non-mortgage applications, the report a consumer will receive after submitting a request may very likely differ from the report the creditor reviewed. Errors from duplicate scores and/or mixed reports that may result from incomplete or incorrect keying of information during the file request will not be apparent if the consumer correctly requests his or her file. One in ten consumer applications results in an additional report being returned by the repository.

B. Require decisions based on a single repository's credit report or credit score that result in anything less than the most favorable pricing to immediately trigger a re-evaluation based on all three repositories at no additional cost.

Lenders and other credit data users have a desire to keep their underwriting costs low. This is a legitimate desire so long as consumers are not harmed in the process. Some reduce costs by underwriting certain decisions with only one credit report. For example, a lender may offer pre-approval letters based on only one report, or underwrite home equity lines of credit or second mortgages with a single report. Given the wide range between scores for a typical consumer and the frequency with which major accounts are omitted from credit reports, such practices have serious negative implications for consumers.

Measures should be put in place to protect consumers from any negative impact resulting from such underwriting practices. A simple solution would be to require all decisions based on credit to use information from all three repositories. However, this could result in higher costs and reduced availability of products such as pre-approval letters that are beneficial to consumers.

Alternatively, lenders and other credit data users could be permitted to continue underwriting based on one report, so long as any adverse impact based on information from a single repository immediately triggers a re-evaluation with information from all three repositories at no additional cost to the consumer. In this manner, businesses could continue to save on underwriting costs for consumers with very good credit, but consumers with less than perfect credit would not be forced to continue to pay a high price for inaccuracies, inconsistencies, or incompleteness on any one credit report.

C. Strengthen requirements for complete and accurate reporting of account information to credit repositories, and maintenance of consumer data by the repositories, with adequate oversight and penalties for non-compliance.

Many errors in credit reports can be attributed to the practices of creditors and other credit data users rather than to repositories. For example, some data furnishers may not report to every credit bureau. Others may consciously misreport or omit information regarding an account in order to prevent other lenders from approaching a valuable customer with competing offers (such as credit card lenders not reporting the true available credit amount so that the borrower appears to have a much higher debt-to-available credit ratio and appears to pose greater risk when other lenders review the credit report). Appropriate government entities such as the Federal Trade Commission and federal banking regulators should require accurate and complete reporting of credit information to the repositories by any entity that uses credit data to make evaluations and conduct regular examinations for compliance. In addition to scrutinizing reporting entities, a government entity (such as the Federal Trade Commission) should audit the repositories' records on a regular basis to identify data furnishers who report incomplete or incorrect information to the repositories. Such activity should be subject to fines or other penalties for non-compliance. These audits should also assess the overall accuracy of data maintained by the credit repositories, with appropriate fines or other penalties for inaccuracy.

Some may perceive tension between consumers' interest in keeping their information private and their interest in having evaluations of their creditworthiness be based on an accurate record of their past behavior. However, consumers generally object to information sharing for secondary purposes, not in the regulated Fair Credit Reporting Act context, provided it is subject to Fair Information Practices. The cost of incorrect information is high, and it is possible to simultaneously serve both consumer interests reasonably well.

Not all providers of consumer services use credit records or credit scores to determine consumer eligibility, or pricing. However, those that do should be required to complete

the cycle of information and report complete and accurate information back to the credit repositories. Information about any account that was underwritten with a report from one or more credit repositories should be reported to those repositories as frequently as the consumer is obligated to make payments. Collection agencies should be required to report on the status of collections at least once every six months.

D. Establish meaningful oversight of the development of credit scoring systems.

Despite the fact that consumer access to, and pricing for, vital services such as mortgages, general consumer credit, insurance, rental housing, and utilities is increasingly dictated by the automated evaluation of credit, there is no government oversight of the design of these systems. The calculations behind credit scores, a fact of life for the American consumer, remain shrouded in secrecy.

The design of credit scoring systems involves a number of deliberate choices that can have a dramatic impact on consumers and can result in systems that are flawed or unfair. These choices can range from determining the relative impact of various consumer actions to establishing the system defaults for cases where information such as date of last activity is not reported, to designing the logic for interpreting public records or contradictory information reported for an account.

A wide variety of entities have developed scoring models³⁰, including Fair Isaac and Company, large mortgage lenders (such as Countrywide and GE Capital), the Federal Housing Administration and Department of Veterans Affairs loan guarantee programs, the Government Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac, private mortgage insurance companies (such as PMI Mortgage Insurance Company and Mortgage Guarantee Insurance Corporation), and insurance companies. However, the only federal review of the fairness of any such models was a HUD review of the GSE systems conducted in 2000, the findings of which are expected to be released soon³¹. While the delayed release will limit the relevance of this review because the GSEs have made significant changes to their automated underwriting systems since the review was conducted, we recommend other agencies follow this example and conduct full reviews of all scoring systems in the marketplace.

We recommend that appropriate government agencies, such as HUD, the Federal Trade Commission, and state insurance departments conduct regular, comprehensive evaluations of the validity and fairness of all credit scoring systems, including any automated mortgage underwriting systems, insurance underwriting systems, tenant and employee screening systems, or any other systems or software that uses credit data as part of its evaluation of consumers, and report to Congress with its findings. These evaluations should be conducted and released in a timely fashion so that developers can react to any recommendations and so the reviews do not become outdated as new versions of scoring software are developed and distributed. Strong oversight of scoring

³⁰ Straka, John. 2000. A Shift in the Mortgage Landscape: the 1990s Move to Automated Credit Evaluations. *Journal of Housing Research*. Volume 11, Issue 2.

³¹ Felsenthal, Mark. "HUD Secretary – mortgage software bias study out soon." Reuters. October 22, 2002.

systems that identifies and protects consumers from any abuses will foster consumer confidence in these powerful and increasingly utilized evaluation tools.

E. Address important questions and conduct further research.

In the course of conducting this study, several questions arose which are not comprehensively addressed in this report, but are deserving of further attention and research. This report primarily addresses the impact of wide variations in credit scores and credit data on consumers who are seeking credit – particularly mortgages. Future studies should explore the impact of these variations on insurance availability and affordability, given the recent, dramatic increase in the use of credit scores as an insurance underwriting tool. In addition, further research should address the impact of data and credit score variations on consumers as a result of other applications, such as tenant screening and employee screening. Additional research could assess the value to consumers of fee-based credit monitoring services.

Other topics raised in this report, but not exhaustively addressed, include determining the value to consumers of credit re-scoring relative to other means of credit data validation, the impact of anti-competitive market forces surrounding credit re-scoring, the privacy concerns surrounding the appearance of medical related information in credit reports, and ways to protect consumers from abusive applications of such medical information. The FTC should promptly develop and require a mechanism to obscure medical debtor names in credit reports.

The Fair Credit Reporting Act prohibits states from enacting any laws that provide protections beyond those guaranteed by federal statute. On January 1, 2004 this provision will expire, although the federal law will otherwise remain in place. Contrary to some characterizations, the entire act will not “sunset” on this date. This prohibition on supplemental state protections should not be extended, and if any changes to the Fair Credit Reporting Act are to be made at the federal level, they should result in greater consumer protections and address the problems raised in this and other research.

IX. Recommendations for Consumers

Many of the concerns raised by this study address structural issues regarding the system of reporting and evaluating credit, which are beyond the scope of most consumers to influence. However, there are some steps consumers can take to reduce the likelihood of errors occurring, or to address them when they arise.

- ? Maintain consistency in credit applications: use your full legal name when applying for credit. If you have a generational title (Sr., Jr., III) always specify this.
- ? Review your credit record regularly by purchasing a credit report and score from each major credit repository once a year. The repositories can be contacted at the following phone numbers and website addresses: Equifax (800) 685-1111 or www.equifax.com; Experian (888) EXPERIAN or www.experian.com; Trans Union (800) 888-4213 or www.transunion.com.
- ? Prior to applying for a mortgage, consider obtaining a current copy of your credit report and score from each major repository, and review it for errors.
- ? Dispute any errors that appear on your credit report by contacting the credit repository. However, avoid “credit repair” businesses that claim to be able to erase valid items in consumers’ credit histories.
- ? Don’t underrate your credit. Ask for specifics if a lender tells you that you have bad credit and don’t qualify. Currently lenders do not have to tell you the specifics, or show you the credit report that they review, but they are permitted to. If a lender refuses to talk to you about the specifics of your credit report, consider a different lender.
- ? If you have complaints about your credit report and are unable to have them quickly resolved, contact the Federal Trade Commission at 1-877-FTC-HELP or www.ftc.gov.



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FOR IMMEDIATE RELEASE

***NEW REPORT REVEALS INDUSTRY-WIDE FAILURES IN
HANDLING ERRORS IN CREDIT REPORTS***

BOSTON, January 24, 2009 – A key component of credit reporting protections for consumers – the dispute system mandated by the Fair Credit Reporting Act – has been automated into a travesty of justice, finds a new report issued by the National Consumer Law Center.

The report, entitled *Automated Injustice: How a Mechanized Dispute System Frustrates Consumers Seeking to Fix Errors in Their Credit Reports*, documents how the three major credit bureaus (Equifax, Experian, and TransUnion) handle credit reporting disputes in a perfunctory, formalistic manner. The report details how credit bureaus:

- Translate detailed disputes painstakingly written by desperate consumers into two or three digit codes.
- Fail to send documents submitted by consumers, such as cancelled checks or payoff statements, to creditors and other information providers involved in the dispute.
- Limit the role of their employees who handle disputes, or of the foreign workers employed by their offshore vendors, to little more than selecting these two or three digit codes. Workers do not examine documents, contact consumers by phone or email, or exercise any form of human discretion in resolving a dispute.

“The credit reporting dispute system is the definitive example of how an industry has automated handling of consumer complaints to the point of absurdity,” noted the report’s author, NCLC Staff Attorney Chi Chi Wu, “This is voicemail hell with a potentially devastating financial impact.”

The NCLC report includes several examples of consumers whose financial lives were ruined by unresponsive handling of serious errors in their credit reports, including

one consumer who took his life after battling with credit bureaus to get his credit report fixed so he could buy a house.

“The examples in this report are just the tip of the iceberg” stated Attorney Leonard Bennett, a report contributor and specialist in credit reporting litigation, “I see hundreds of consumers with similar problems each year.”

The newly released NCLC report also discusses how some creditors and information providers also shirk their federally mandated responsibility to investigate. The investigative activity of these companies consists primarily of ensuring “data conformity” between records maintained by the credit bureaus and the companies’ records – the information that is itself the very subject of the dispute. In turn, credit bureaus merely “parrot” the information provider’s results, without conducting any independent review.

The new NCLC report discusses the economic reasons for this dysfunctional system, primarily that the credit bureaus have little incentive to conduct proper disputes because creditors, not consumers, are the bureaus’ paying customers. Because disputes represent only an expense, the bureaus have minimized the resources to the point that one bureau pays its dispute-handling vendor in the Philippines a mere \$0.57 per dispute letter.

“Unlike almost all other business relationships, consumers who are unhappy with a credit bureau can’t vote with their feet – they can’t take their business elsewhere,” noted Evan Hendricks, a report contributor and editor of Privacy Times, “They are trapped in a relationship with a company that has so much power over their financial lives, and so little regard for their financial well-being.”

NCLC’s report *Automated Injustice* is available at http://www.nclc.org/issues/credit_reporting/content/automated_injustice.pdf .

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NCLC is a non-profit organization specializing in consumer issues on behalf of low-income people. NCLC works with thousands of legal services, government and private attorneys, as well as organizations, who represent low-income and elderly individuals on consumer issues.

NATIONAL CONSUMER LAW CENTER'S REPORT

**AUTOMATED INJUSTICE:
HOW A MECHANIZED DISPUTE
SYSTEM FRUSTRATES
CONSUMERS SEEKING TO FIX
ERRORS IN THEIR CREDIT
REPORTS**

January 2009



NATIONAL
CONSUMER LAW
CENTER®



**Automated Injustice:
How a Mechanized Dispute
System Frustrates Consumers
Seeking to Fix Errors in Their
Credit Reports**

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Portions this report are based on the Congressional testimony of Leonard A. Bennett, a consumer attorney specializing in credit reporting cases, to the House Financial Services Committee during a June 2007 hearing. It also follows the work of Evan Hendricks, editor of *Privacy Times*, and the author of *Credit Scores and Credit Reports: How the System Really Works, What You Can Do*, which contains additional information about this topic and many other important issues concerning credit reporting.

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Copies of this report are available by downloading from NCLC's web site at www.consumerlaw.org.

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EXECUTIVE SUMMARY

Inaccuracies and errors plague the credit reporting systems. Estimates of serious errors range from 3% to 25%. Even using a low-end estimate, which is from the credit reporting industry and included only a narrow subset of problems, *6 million Americans* face serious errors in their reports that could result in a denial of credit. Typical errors include:

- Credit bureaus mixing the files and identities of consumers.
- Creditors causing mistakes by attributing a debt to the wrong consumer or incorrectly recording payment histories.
- The fallout caused by identity theft.

Nearly 40 years ago, Congress enacted the Fair Credit Reporting Act to protect consumers from errors in credit reporting. One of the most important safeguards in the FCRA is the requirement that credit bureaus conduct a reasonable investigation when a consumer disputes an item in his or her credit report.

Despite its importance, the FCRA dispute process has become a travesty of justice. The major credit bureaus (Equifax, Experian, and TransUnion) conduct investigations in an automated and perfunctory manner. The bureaus:

- Translate the detailed written disputes submitted by desperate consumers into two or three digit codes.
- Fail to send supporting documentation to creditors and other information providers (furnishers) as required by the FCRA.
- Limit the role of their employees who handle disputes, or of the foreign workers employed by their offshore vendors, to little more than selecting these two or three digit codes. Workers do not examine documents, contact consumers

by phone or email, or exercise any form of human discretion in resolving a dispute.

The conduct of some furnishers is no better. The FCRA also requires information furnishers to participate in dispute resolution by themselves conducting an investigation. Like the credit bureaus, some furnishers also conduct meaningless, non-substantive investigations. Their “investigative” activity consists of nothing more comparing the notice of dispute with the recorded information that is itself the very subject of the dispute.

The credit bureaus then accept whatever the furnishers decide in resolving the dispute. The bureaus merely “parrot” the furnishers’ results, without conducting any independent review, with the ultimate effect that no one ever investigates the substance or merits of the consumer’s complaint.

Why does this happen? Credit bureaus have little economic incentive to conduct proper disputes or improve their investigations. Consumers are not the paying customers for credit bureaus – furnishers are the ones who pay the bureaus’ bills. Thus, consumer disputes represent an expense to the bureaus, which minimize the resources devoted to them by using automation that produces formalistic results. In fact, one credit bureau has reduced the amount it pays to its vendor that handles disputes to a mere **\$0.57** per dispute letter.

I. INTRODUCTION

Credit reports play a critical role in the economic health and well-being of consumers and their families. A good credit history (and its corollary, a good credit score) enables consumers to obtain credit, and to have that credit be fairly priced. Credit reports are also used by other important decisionmakers, such as employers, landlords, utility providers, and insurers.

Thus, a consumer's credit report can have a huge impact on a consumer's life. A good credit report allows a consumer to own a home, buy a car, obtain insurance for both, get a fairly priced credit card, and perhaps even secure a job. Conversely, a bad credit report will deny consumers those same things, or force them to pay thousands more for credit and insurance. It may even cost the consumer an employment opportunity or result in termination. It is no exaggeration to say that a credit history can make or break a consumer's finances.

*Kenneth Baker*¹

Kenneth Baker had a single financial objective from the early part of 2005 until March 2006 – he wanted to move his family into a new home. The family home in Loudoun County, Virginia was too cramped for his wife, daughter, and wife's children. In order to move, Kenneth needed approval for a mortgage. It shouldn't have been too hard – after all, Kenneth had always paid his bills on time.

Unfortunately for Kenneth, his credit history had become "mixed" with that of another "Kenneth Baker" – a Kenneth Baker who was not so diligent about paying his bills. This other man had racked up numerous delinquencies, charge-offs, collections and judgments against him. These black marks showed up on Kenneth's credit report, making it impossible for him to get a mortgage.

Kenneth made enormous efforts to fix these errors and get a mortgage. He sent multiple disputes to the credit bureaus. He hired lawyers to write dispute letters to the bureaus. His letters explained how the other man's negative accounts had gotten mixed into his credit report, how he needed the problem fixed to get a mortgage, and even how the bureaus procedures had caused similar problems in other cases that resulted in successful lawsuits against the bureaus.

Kenneth applied unsuccessfully every month to get a mortgage, sometimes applying more than once in a month. Every time he tried, Kenneth had to explain to a mortgage broker how some other man's negative accounts had gotten mixed into his credit history. Every time he had to explain this, Kenneth Baker became embarrassed and anxious. The constant rejections humiliated Kenneth, and he soon became depressed.

On March 24, 2006, Kenneth Baker committed suicide. In his last dispute letter to Experian, he wrote of how his battle to fix his credit report had "destroyed his life." In his suicide note, Kenneth referred to his ordeal with the credit bureaus. In this case, inaccurate credit reporting literally cost a man his life.

¹ Complaint, Estate of Baker v. Experian Info. Solutions, Civ. Ac. 3:07-cv-00470 (Aug. 10, 2007).

II. BACKGROUND: CREDIT REPORTS AND THE FAIR CREDIT REPORTING ACT

A. WHAT'S A CREDIT REPORT?

A credit report (also called a credit history) is a record of how a consumer has borrowed and repaid debts. Almost every adult American has a credit history with the three major national credit bureaus: Experian, Equifax, and TransUnion.

A credit report contains the history and status of many of a consumer's credit accounts. It has basic personal information about a consumer--Social Security number, birth date, current and former addresses, and employers. The report also lists basic information about a consumer's credit accounts, including the date the consumer opened the account, the type of account (such as real estate, revolving (credit card), or installment); whether the account is currently open or has been closed; the monthly payment; the maximum credit limit; the latest activity on the account; the current balance; and any amounts past due.

Each account includes a code that explains whether the account is current, thirty days past due, sixty days past due, or ninety days past due, or if the account involves a repossession, charge off, or other collection activity. The report also includes the addresses and telephone numbers of the creditors.

The report will list any accounts that have been turned over to a collection agency. In addition, a credit report will include certain public records information, such as court judgments (and sometimes mere lawsuits), garnishments, tax liens, foreclosures, and bankruptcies.

B. DISPUTE RIGHTS UNDER THE FCRA

In 1970, Congress created the Fair Credit Reporting Act (FCRA) to protect consumers when dealing with credit bureaus. The FCRA limits who can see a consumer's credit report, mandates how long negative information can remain on a report, and contains a number of identity theft protections. The credit bureaus, which are called "consumer reporting agencies" under the FCRA, are required to follow "reasonable procedures" to ensure the "maximum possible accuracy" of credit reports.

One of the most critical FCRA protections is the consumer's right to dispute errors in his or her credit report. Under the FCRA, both the credit bureaus and the information provider have responsibilities to investigate disputes and correct inaccurate or incomplete information. The provider of information is often referred to as the "furnisher." Furnishers include banks, credit card companies, auto lenders, collection agencies or other businesses.

If the consumer sends a dispute to a credit bureau, the bureau must investigate the items in question, usually within 30 days. The bureau can reject the dispute if it

determines the dispute to be frivolous or irrelevant. The credit bureau must conduct a “reasonable” investigation (sometimes called a “reinvestigation,” which is the term used in the FCRA) that includes reviewing and considering all relevant information submitted by the consumer. Within five days of receiving the dispute, the bureau must also notify the furnisher of the dispute, and the notice must include “all relevant information” provided by the consumer about the dispute.

After the furnisher receives notice of a dispute from the credit bureau, the furnisher has its own duties under the FCRA. The furnisher must conduct an investigation, review all relevant information provided by the credit bureau, and report the results to the bureau. If the furnisher finds the disputed information to be inaccurate, it must notify all three of the national bureaus so that they can correct this information in the consumer’s credit report file.

When the investigation is complete, the credit bureau must give the consumer the written results and a free copy of the credit report if the dispute results in a change. If information is corrected or deleted, the credit bureau cannot put back the disputed information in the consumer’s credit report unless the furnisher verifies that it is accurate and complete. The credit bureau also must send the consumer a written notice that includes the name, address, and phone number of the furnisher.

For tips on sending a credit reporting dispute, see Part V.A of this Report.

C. CREDIT REPORTS ARE FULL OF ERRORS

Despite the importance of accurate credit reports and the purpose of the FCRA to promote accuracy, errors are unfortunately quite common in the credit reporting system. Study after study has documented significant error rates in credit reports. An on-line survey by Zogby Interactive found that 37% of consumers who ordered their credit report discovered an error, and 50% of those were not easily able to correct the error.² A study by the Consumer Federation of America and National Credit Reporting Association documented numerous serious errors in credit reports.³ One indication of the magnitude of such errors is the fact that 29% of credit files had a difference of 50 points or more between the highest and lowest scores from the three national credit bureaus.⁴

Studies from U.S PIRG and Consumers Union have found errors in 25% of credit reports serious enough to cause a denial of credit.⁵ Even the trade association for the credit bureaus – the Consumer Data Industry Association (CDIA) - has admitted that, out

² Zogby Interactive, *Most Americans Fear Identity Theft*, Zogby’s American Consumer, April 2007, at 3.

³ Consumer Federation of America and National Credit Reporting Association, *Credit Score Accuracy and Implications for Consumers*, December 17, 2002, available at www.consumerfed.org/pdfs/121702CFA_NCRA_Credit_Score_Report_Final.pdf [“(CFA-NCRA study)”].

⁴ *Id.* at 20.

⁵ Nat’l Ass’n of State PIRGs, *Mistakes Do Happen: A Look at Errors in Consumer Credit Reports*, at 11 (2004); Consumers Union, *What Are They Saying About Me? The Results of a Review of 161 Credit Reports from the Three Major Credit Bureaus* (Apr. 29, 1991).

of 57.4 million consumers who ordered their own credit reports, 12.5 million (or 21.8%) filed a dispute.⁶

The FTC is currently undertaking a comprehensive study of errors in credit reports using a consultant to help study participants order and review their credit reports. In the pilot phase of the study, 53% (16 out of 30) of consumers found an error in their credit reports. Sixteen percent of the consumers found errors that either would have likely had a material effect on their credit score (3 out of 30), or the effect was uncertain (2 out of 30).⁷ The study may have undercounted the error rate because it was skewed toward consumers with high credit scores, who the study indicated “not surprisingly” were less likely to have major significant errors in their credit reports.⁸

The credit reporting industry has attempted to rebut charges of systemic inaccuracies in credit reports with their own studies, claiming that fewer than 3% of credit reports are inaccurate.⁹ However, the industry reached this statistic by counting as “inaccurate” only those credit reports in which the consumers fulfilled all four of the following criteria: (1) were denied credit; (2) requested a copy of their credit report; (3) filed a dispute; and (4) the dispute resulted in a reversal of the original decision to deny credit. This study did not include inaccuracies in the credit reports of consumers who did not apply for or were denied credit, had not filed a dispute, or who did not seek a reversal of the original denial of credit. This could be a significant number of consumers for many reasons, such as the fact that some lenders do not deny credit but instead simply charge more if the consumer has an impaired credit report, and the barriers faced by many consumers who do not file disputes even when they know of blatant errors.

Indeed, many consumers with errors in their reports do not send disputes because of barriers such as lack of time or resources, educational barriers, and not knowing their rights. In the FTC study discussed above, only one of the consumers who definitely had a major error in his/her credit report was successfully able to dispute it, despite the assistance of the FTC’s consultant. Another consumer disputed on-line and the credit bureau did not respond. The third consumer explained that she did not file a dispute because “she was a single mother with twins and could not muster the time to file a dispute.” The consultant mused that “[w]e expected that participants would be motivated to have any errors in their credit reports corrected promptly. This did not generally occur.”¹⁰

⁶ Federal Trade Commission and Federal Reserve Board, *Report to Congress on the Fair Credit Reporting Act Dispute Process* (Aug. 2006), at 12, available at www.ftc.gov/os/comments/fcradispute/P044808fcradisputeprocessreporttocongress.pdf. [hereinafter “FTC/FRB FCRA Dispute Process Report”].

⁷ Federal Trade Commission, *Report to Congress Under Section 319 of the Fair and Accurate Credit Transactions Act of 2003* (December 2006), Appendix at 15, available at http://www.ftc.gov/reports/FACTACT/FACT_Act_Report_2006_Exhibits_1-12.pdf [hereinafter “FTC Pilot Study on Accuracy”].

⁸ *Id.* at 15-16.

⁹ Federal Trade Commission, *Report to Congress Under Sections 318 and 319 of the Fair and Accurate Credit Transactions Act of 2003* (Dec. 2004), at 25, available at <http://www.ftc.gov/reports/facta/041209factarpt.pdf> [hereinafter “FTC 2004 FACTA Report”] (citing an Arthur Andersen study commissioned by the credit bureaus).

¹⁰ FTC Pilot Study on Accuracy, Appendix at 17.

Even using the industry's low estimate of a 3% serious error rate, there are over 200 million consumers in this country with a credit report on record at the credit bureaus.¹¹ Thus, 3% of 200 million files would mean that inaccurate credit reports are affecting the economic well-being of *6 million Americans*. One of the primary purposes of the FCRA is to give these consumers the right to have the errors investigated and fixed.

D. FREQUENT TYPES OF CREDIT REPORTING ERRORS

There are many types of errors in credit reports; we focus on a few of the most egregious.

Mixed files

Mixed or mismerged files occur when credit information relating to one consumer is placed in the file of another, thus creating a false description of both consumers' credit histories. Mismerging occurs most often when two or more consumers have similar names, Social Security Numbers (SSNs), or other identifiers (for example, when information relating to John J. Jones is put in John G. Jones' file).

Mixed or mismerged files are a frequent problem. One study found that 44% of credit reporting complaints to the FTC involved mismerged files. Of these complaints, 64% had total strangers' files mixed in, while 36% involved information belonging to relatives or former spouses.¹² Another study found that one in ten files contained at least one, and as many as three, additional credit reports. It was very common for the additional reports to contain a mixture of credit information, some of which belonged to the subject of the report requested and some which did not.¹³

Mixed files also result in debt collection harassment and lawsuits against innocent consumers. One of the first steps a collection attorney will take when he or she receives an assigned file is to request a skip trace from one of the national credit bureaus. These reports are often the broadest matched files provided by the bureaus. It is common for collection attorneys to receive an incorrectly matched report and to sue the wrong consumer.¹⁴

Mixed files occur largely because the credit bureaus' computers do not use sufficiently rigorous criteria to match consumer data precisely, even when such unique identifiers as SSNs are present. For example, the credit bureaus will include information

¹¹ FTC/FRB FCRA Dispute Process Report at 3.

¹² U.S. Public Interest Research Group, *Credit Bureaus: Public Enemy #1 at the FTC*, October 1993. In this sample, U.S. PIRG analyzed 140 complaints to the FTC.

¹³ CFA-NCRA Study at 10.

¹⁴ *Credit Reports: Consumers' Ability to Dispute and Change Inaccurate Information: Hearing before the House Committee on Financial Services*, 110th Congr. (2007) (statement of Leonard A. Bennett), at 10, available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/osbennett061907.pdf. [hereinafter "Leonard Bennett Testimony"]

in a consumer's file even when the SSNs do not match, but other information appears to match.¹⁵ Thus, they have been known to mismerge files when the consumers' names are similar and they share seven of nine digits in their SSN.¹⁶

*Angela Williams*¹⁷

Angela Williams, a medical transcriptionist from Orlando, Florida, had a bad credit report. Her Equifax report included at least 25 accounts showing negative information. The problem was that none of these accounts belonged Angela Williams. Instead, they belong to Angelina Williams, a woman whose only connection with the medical transcriptionist was a similar name and a Social Security number that was almost the same - the last two digits were reversed.

Angela Williams spent a total of 13 years trying to get her credit report fixed. She sent dispute after to dispute to Equifax. Occasionally, Equifax would delete one of false accounts from Angela's credit report, only to have the account show up again later. Even after being notified of this problem through Angela's disputes, new accounts from the other woman would appear in Angela's report.

Worse yet, creditors and debt collectors who were pursuing the other woman would order reports from Equifax and get Angela's information. Soon they started wrongfully pursuing Angela for the other woman's debts.

These repeated errors over a 13 year period took an enormous toll on Angela Williams. Her credit score dropped into the 500s – well below the subprime cutoff. She was denied credit repeatedly and even told to leave one store after an employee viewed her credit report. The ordeal caused Angela tremendous stress and frustration. Finally, she sought the assistance of a lawyer and filed a lawsuit against Equifax.

Equifax fought this lawsuit long and hard, despite glaring evidence that it had mixed up Angela Williams' credit report with that of the other woman. In November 2007, a jury found in favor of Angela Williams, and entered a verdict against Equifax for \$219,000 in actual damages and \$2.7 million in punitive damages.

Mixed files could be prevented by requiring the credit bureaus to use strict matching criteria when placing information into a consumer's credit report. The most critical reform would be to require an exact match of Social Security numbers. The credit bureaus could reduce mixed file problems by merely requiring an eight of nine SSN match and a flag if that match isn't perfect. However, the credit bureaus have chosen to be excessively and unreasonably over-inclusive because, as the FTC noted in a 2004 report mandated by the Fair and Accurate Credit Transactions Act of 2003: "lenders may prefer to see all potentially derogatory information about a potential borrower, even if it cannot all be matched to the borrower with certainty. This preference could give the credit bureaus an incentive to design algorithms that are tolerant of mixed files."¹⁸ Indeed, an erroneously low credit score may even provide the furnisher with more profit,

¹⁵ FTC 2004 FACTA Report at 40.

¹⁶ See, e.g., *Apodaca v. Discover Fin. Servs.* 417 F.Supp.2d 1220 (D.N.M. 2006).

¹⁷ *Consumer Victory: Equifax Must Pay \$2.9 million for Mixing Up Credit Files*, The Consumer Advocate, Vol. 14, No. 1, National Association of Consumer Advocates (Jan.-Mar. 2008) at 14; *Consumer Wins Fight For Credit Report Accuracy*, Privacy Times, Dec. 6, 2007.

¹⁸ FTC 2004 FACTA Report at 47.

because the consumer will be charged a higher rate, a practice known as “risk-based pricing.”

The credit bureaus have been aware of mixed file errors for decades.¹⁹ In the early to mid-1990s, the FTC reached consent orders with the credit bureaus requiring them to improve their procedures to prevent mixed files.²⁰ However, over a decade later, mixed files remain a significant problem. Despite the recognition of the continuing nature of mixed file issues in its 2004 report, the FTC has not required the credit bureaus to improve their matching criteria.

Identity Theft

Identity theft is often called the “fastest growing crime” in this country, with an estimated eight million consumers victimized by some form of identify theft every year.²¹ Identity theft itself presents a serious source of inaccuracies in the credit reporting system. The identity thief, however, is not the only culprit. Credit bureaus and furnishers bear a share of the blame as well.

The credit bureaus’ loose matching procedures, discussed above, contribute to identity theft problems. For example, if a thief has only adopted the victim’s first name and Social Security number but not his or her last name or address, the algorithm used by credit bureaus to “merge” information often will incorporate the thief’s information into the victim’s file at the time the bureau compiles the report. Once the fraudulent debt is reported, often after default and non-payment, and especially when collectors begin attempting skip trace searches, the account ends up merged into the victim’s file even though many of the identifiers do not match. Accordingly, the “identity theft” is really characterized as a hybrid of a mixed file problem.

*The Litchfields*²²

Susan and David M. Litchfield of Norwell, Massachusetts, battled the credit bureaus for six years to erase numerous debts on their record that were incurred by a David J. Leighton of Tampa. The Litchfields even obtained a copy of one credit card agreement they had allegedly signed, which upon review showed Leighton’s signature, along with David M. Litchfield’s Social Security number neatly penned in.

Even with this evidence, the credit bureaus did not fix the errors. The Litchfields sent disputes to all three bureaus telling them of the apparent fraud, to no avail. They disputed more than a dozen items on the report, including a Tampa child support order for \$19,060 on their Experian report.

The bureaus’ nonresponsive was costly to the Litchfields, who were rejected for a student loan for their daughter, had their credit card interest rates raised to penalty levels, and were forced to pay more for a

¹⁹ For an example of a mixed file case dating from the late 1970s, see *Thompson v. San Antonio Retail Merchants Ass’n*, 682 F.2d 509 (5th Cir. 1982).

²⁰ *FTC v. TRW, Inc.*, 784 F. Supp. 361 (N.D. Tex. 1991), *amended by* (N.D. Tex. Jan. 14, 1993); In the Matter of Equifax Credit Information Services, Inc., 61 Fed. Reg. 15484 (Apr. 8, 1996) (consent order).

²¹ Synovate, Federal Trade Commission – Identity Theft Survey Report, Nov. 2007, at 3, *available at* <http://www.ftc.gov/os/2007/11/SynovateFinalReportIDTheft2006.pdf>.

home equity loan from the bank where Susan Litchfield had done business her entire life. "I just sat here and cried," she said.

Finally it took the intervention of the Boston Globe for TransUnion to agree to work with the Litchfields. What happens to identity theft victims who don't have the assistance of a major metropolitan newspaper?

Furnisher errors

Furnishers can often be the source of errors in credit reports. Furnisher inaccuracies primarily fall into two categories types. First, the furnisher might report the consumer's account with an incorrect payment history, current payment status, or balance. The error might be due to a misapplied payment or data entry error. Sometimes these errors occur because the creditor has not complied with industry reporting standards, such as the Metro 2 format.

George Saenz²³

George Saenz's credit report became another victim of the broken American health care system. In 2001, he incurred a \$512 medical bill that he couldn't pay. It went into collections and was sold to NCO, a large debt collector. NCO reported the debt to the credit bureaus.

NCO contacted Saenz, and in August 2003, accepted a compromise payment of \$333 in full satisfaction of the outstanding debt. Justifiably thinking that he had cleared the debt, Saenz sent a dispute to TransUnion informing the bureau that he had paid off the NCO account.

TransUnion turned around and referred the dispute to NCO. Despite the fact that Saenz had just paid off the debt, NCO's automated systems responded to TransUnion that the debt was unpaid.

Saenz sent a second dispute on September 30, 2003. This time he included documentary evidence that the dispute had been paid, including a letter from NCO offering to settle the debt for \$333, a receipt for a \$333 money order payable to NCO, and a certified mail receipt.

TransUnion sent a second automated dispute form to NCO. However, TransUnion did not provide NCO with copies of the documents sent by Saenz, nor did it ask NCO about the authenticity of the documents. In fact, TransUnion didn't even ask NCO whether NCO had received the \$333 payment.

NCO's automated system again erroneously verified that Saenz had not paid off the debt. Frustrated, Saenz filed a lawsuit against NCO and TransUnion. In January 2007, three and a half years after Saenz paid off the debt, and only after a federal lawsuit was filed, did TransUnion remove the debt from his credit report.

The second type of dispute involves furnishers who have attributed a credit account to a consumer who does not owe the debt, often called an "ownership dispute." This type of dispute often involves a spouse or other authorized user who is not contractually liable for a debt. Other times, the consumer may have been the victim of identity theft. According to credit reporting industry statistics, these "ownership"

²² Beth Healey, *Credit Agencies Lag on Errors, Fraud*, Boston Globe, Dec. 28, 2006.

²³ Saenz v. TransUnion, LLC, 2007 WL 2401745 (D. Or. Aug. 15, 2007).

disputes are among the most common, as the bureaus use the dispute code “consumer states account is not his/hers” over 30% of the time.

Any error sent by the furnisher in its computer file automatically appears in the consumer’s credit report, even if the information patently contradicts information appearing in other parts of the credit report. The national credit bureaus unfortunately fail to exercise virtually any quality control over the information initially provided to them by furnishers. The credit bureaus blindly rely on furnishers and provide no oversight of the quality of the information being reported. This unquestioning acceptance and re-publication of furnisher information invites abuse. This is especially true when it comes to debt collectors and debt buyers, who present their own special types of errors.

*Charles King*²⁴

Charles King's ex-girlfriend did a number on him. She opened up at least one, if not more, credit card accounts in his name, charged them up, and stuck him with the bill. After charging off the account as delinquent, First Consumers National Bank sold an account in King's name to Asset Acceptance, a large debt buyer. As usual for debt buyers, Asset Acceptance did not have any of the original account documents from First Consumers.

The debt showed up on King's credit report under Asset Acceptance's name. King justifiably disputed this information to the credit bureaus. After all, he was the victim of identity theft. He had not opened the account or used the credit card.

The credit bureaus referred the dispute to Asset Acceptance. In turn, all that Asset Acceptance did was to merely compare the data in its files – the same files that had produced the disputed information - with the identical information that the bureaus were naturally then reporting. Asset Acceptance did not request the original documents from First Consumers - documents that might have shown the signature on the credit card account did not match King's signature.

Instead, Asset Acceptance's usual procedure in an identity theft investigation was to ask the consumer to send it a fraud affidavit – and Asset did not even make this request in King's case at all. How did Asset Acceptance conduct proper investigations for identity theft without looking at the signature on the original credit card application to see if it was forged or not?

Re-aging of obsolete debts

A type of abuse by debt collectors that results in inaccurate reporting is the “re-aging” of obsolete debts. The FCRA requires most consumer debts to be deleted from a credit report after seven years from the date of charge-off or 180 days after the delinquency.²⁵ “Re-aging” occurs when debt buyers purposefully misrepresent the critical date of delinquency, which is the trigger date from which the seven years is counted. Debt buyers report a date of delinquency that falls within the seven-year period,

²⁴ King v. Asset Acceptance, 452 F.Supp.2d 1272 (N.D. Ga. 2006).

²⁵ 15 U.S.C. § 1681c(a).

thus resurrecting long dormant and nearly worthless debts with the simple act of false credit reporting.

This problem has grown particularly prevalent and profitable in recent years with the emergence of a multi-billion dollar distressed debt industry that buys, sells, and re-buys large portfolios of defaulted and time-barred debt for pennies on the dollar and then duns vulnerable consumers for inflated sums. In 2000, the FTC imposed a \$2 million civil penalty against one debt buyer, Performance Capital Management, for repeated instances of re-aging debts as well as conducting inadequate perfunctory investigations.²⁶

The credit bureaus play a role in re-aging abuse as well, failing to control properly for debt buyers who are effectively gaming their systems. The Seventh Circuit expressed its concern over Equifax's procedures concerning the "Date of Last Activity" field, which is the date used by Equifax to calculate the seven year expiration period. The Seventh Circuit noted that Equifax's procedures for this date field could "effectively allow Equifax the opportunity to keep delinquent accounts in the credit file past the seven and one-half year limitation of" the FCRA.²⁷

*Steven Rosenberg*²⁸

Sometime in the early to mid 1990s, Steven Rosenberg had received a phone call from a debt collector about a debt he owed to Fleet Bank. Rosenberg couldn't recall any debt he owed Fleet, and told the debt collector so. The debt collector responded that the debt arose from an account Rosenberg had with NatWest Bank in the 1970s (which Fleet acquired). Rosenberg had closed his account with NatWest in the 1980s, and denied he owed any money when he stopped banking there.

About ten years later, in April 2003, Rosenberg received a letter from Cavalry Investments, a buyer of bad debts, attempting to collect a debt it had bought from Fleet Bank. Again, Rosenberg denied he owed a debt to Fleet. More importantly, he discovered that Cavalry had reported the debt to the credit bureaus with an "opening date" of December 2001.

At about the same time, Rosenberg had been attempting to refinance his mortgage. The lender approved his loan, on the condition that he pay off the debt to Cavalry. Rosenberg refused to pay -- he believed he did not owe the debt. He retained a lawyer, who sent a dispute to Cavalry indicating that the alleged debt, even if Rosenberg owed it, was at least a dozen years old. Rosenberg also sent a dispute to Equifax. Equifax in turn sent the dispute to Cavalry, requesting that Cavalry confirm the "date of last activity" and "opening date" of the account.

Cavalry "verified" the report. Fortunately for Rosenberg, Cavalry failed to provide the requested dates, and thus the account was deleted. However, the harm from the illegally reported debt -- a debt that, even if Rosenberg owed it, was from the 1980s and thus about 20 years old-- was done. Interest rates had risen by then.

²⁶ U.S. v. Performance Capital Management (Bankr. C.D. Cal 2000) (consent decree), *available at* <http://www.ftc.gov/os/2000/08/performconsent.htm>.

²⁷ Gillespie v. Equifax Information Services, 484 F.3d 938 (7th Cir. 2007).

²⁸ Rosenberg v. Calvary Investments, L.L.C., 2005 WL 2490353 (D. Conn. Sept. 30, 2005).

III. YOU CALL THIS AN INVESTIGATION?

The FCRA does not impose strict liability for inaccuracies. Instead, it requires the credit bureaus to “follow reasonable procedures to assure maximum possible accuracy.” That is the first level of protection for accuracy in credit reporting. Unfortunately, Part II of this report shows that the credit bureaus do not always meet their obligations for this level of protection.

For those consumers for whom this first level of protection fails- whether it be 3% or 25% of the U.S. adult population- Congress enacted a second level of protection: the dispute process. The dispute process is the safety net when something goes wrong in the processing of billions of pieces of data for hundreds of millions of files.

The dispute process is critical to ensuring the accuracy of credit reporting, and to protecting the rights of the millions of consumers whose livelihoods, housing, insurance, and access to credit depend on accurate reporting. Congress’s intent in enacting the FCRA’s dispute process and its societal importance were plainly stated by Senator William Proxmire when the FCRA was first introduced in the U.S. Senate:

It would be unrealistic to expect credit reporting agencies to be absolutely correct on every single case. But it seems to me that consumers affected by an adverse rating do have a right to present their side of the story and to have inaccurate information expunged from their file. Considering the growing importance of credit in our economy, the right to fair credit reporting is becoming more and more essential. We certainly would not tolerate a Government agency depriving a citizen of his livelihood or freedom on the basis of unsubstantiated gossip without an opportunity to present his case. And yet this is entirely possible on the part of a credit reporting agency.

115 Cong. Rec. 2412 (1969).

Thus, the dispute process is supposed to be the safety net for consumers plagued by inaccurate credit reporting. Unfortunately, the industry has created gaping holes in that net. The credit reporting dispute system in its current form is fundamentally flawed. The credit bureaus have created an automated and perfunctory process that is a mockery of how a real dispute process should function. This automated dispute system involves credit bureaus converting detailed consumer disputes into cryptic two or three digit codes. The bureaus forward these cryptic codes to the furnishers but do not forward the underlying documentation sent to them by consumers.

Furnishers have a role in this automated injustice. Their investigations of disputes sometimes involve merely verifying that the information matches their own computer records, without undertaking a meaningful examination of the underlying facts. The bureaus accept whatever the furnishers tell them without conducting an independent

review. The continued result of this lackadaisical investigation system is that consumers find it extremely difficult, frustrating, and expensive to dispute errors.

A. HOW AN INVESTIGATION SHOULD WORK

Most people have a general expectation of what an “investigation” of a credit card or loan dispute should look like. An investigation should involve reviewing documents, researching facts, interviewing witnesses, or comparing handwriting. For example, consider the deposition testimony of a bank employee who once worked as a fraud investigator for Zales Jewelers. This employee described how her fraud investigations for Zales included:²⁹

- gathering original documents, including the credit application, the sales tickets, and any statements from the store personnel that were in written form;
- gathering copies of identification and police reports;
- examining the signature of the purchaser on the sales ticket and account application;
- interviewing store personnel, including the store manager, where possible, and the sales associate who had handled the actual transaction;
- preparing statements to be signed by store personnel or taking notes of interviews;
- interviewing the fraud victim because “often they would have additional information that would help us in locating a suspect or determining how the fraud or forgery had occurred.”

This description probably matches with most consumers’ understanding of what should happen in an investigation. Unfortunately, these steps, or anything resembling a real inquiry, rarely occur in a credit reporting dispute.

B. HOW IT REALLY WORKS: THE E-OSCAR SYSTEM

In contrast to the meaningful and substantial investigation described above, credit bureaus have developed a highly automated, computer-driven system that precludes any real investigation. This system converts the often-detailed and painstakingly written dispute letters into nothing more than a two or three digit code, sometimes with a few lines of narrative.

The credit reporting industry uses a standardized form to communicate disputes to furnishers, called a Consumer Dispute Verification form (CDV). An automated version of the form, communicated entirely electronically, is known as Automated Consumer Dispute Verification (ACDV) form. The credit bureaus initiate a request for an investigation with the furnisher by sending an ACDV through an automated on-line processing system called “e-OSCAR” (Online Solution for Complete and Accurate Reporting). In 2006, the industry reported that 83% of disputes were processed using e-

²⁹ Deposition of Elizabeth Aadland, *Smith v. Citifinancial Retail Services*, No. 3:06-cv-02966 (N.D. Cal. March 23, 2007).

OSCAR. Furthermore, each of the three national credit bureaus had announced plans to require that all disputes be processed using e-OSCAR.³⁰

An ACDV simply consists of a few items: identifying information about the consumer in the credit bureau's file; one or two codes summarizing the consumer's dispute; and, in some cases, a one-or-two-line free-form narrative field that supplements the dispute codes. The credit bureau employee selects a specific dispute code from among twenty-six offered by the e-OSCAR system, such as "Not his/hers" and "Claims account closed." These codes are often contained in a dropdown "pick list."³¹

This automated system is heavily dependent upon these standardized dispute codes. Yet these codes are entirely inadequate in many instances to properly convey information about a dispute. As many as 80% of consumer disputes are written.³² These written disputes often consist of a detailed letter with supporting documentation, painstakingly written by concerned and even desperate consumers. All of these documents, including a consumer's careful description of a specific dispute, fashioned to make detection and correction easy, are reduced to a two or three digit code that the bureau employee who glances at the material believes best describes the dispute.

The code is sent to the furnisher without supporting documentation provided by the consumer - documents such as account applications, billing statements, letters, and payoff statements that can show overwhelming and even conclusive proof. These critical documents are left out of the investigation process, which itself may violate the FCRA as discussed below in Part III.F.

Even worse, the credit bureaus reduced the number of dispute codes from 100 choices under their prior system, to 26 under e-Oscar.³³ Most shockingly, of these 26 codes, the credit bureaus use the same four or five codes for the vast majority of all disputes. According to the testimony provided in congressional hearings, credit bureaus used the following codes in the following percentages of disputes:³⁴

Not his/hers	30.5%
Disputes present/previous Account Status/History	21.2%
Claims Inaccurate Information. Did not provide specific dispute	16.8%
Disputes amounts	8.8%
Claims account closed by consumer	7.0%
<u>Total</u>	<u>84.3%</u>

Once the dispute is purportedly investigated, the credit bureaus then send generic and uninformative letters stating that an investigation has been made, without including

³⁰ FTC/FRB FCRA Dispute Process report at 16.

³¹ Leonard Bennett Testimony at 21.

³² See Deposition of Eileen Little, *Evantash v. G.E. Capital Mortgage*, Civ. Action No. 02-CV-1188 (E.D. Pa. Jan. 25, 2003).

³³ Leonard Bennett Testimony at 28.

³⁴ *Id.*

any details as to whom they have contacted and what information was obtained or relied upon for a final determination. As the Seventh Circuit Court of Appeals has noted, the ACDV process is often “cryptic” and “meaningless”:

It seems that Experian has a systemic problem in its limited categorization of the inquiries it receives and its cryptic notices and responses. For example, there is the meaningless communication [plaintiff] received from Experian in response to her notice of dispute: “Using the information provided the following item was not found: Grossinger City Toyota.” Another example is the opaque notice of dispute sent by Experian to U.S. Bank: “Claims Company Will Change or Delete.” Moreover, in what appears to be an unresponsive form letter rather than the report of an adequate investigation into her claim, [plaintiff] was notified that the “Paid/Was a repossession” notation would remain in her report and the only change would be the addition of: “Account closed at consumer's request.”³⁵

When is a “Repossession” Not a Repossession?³⁶

Rosemary Krajewski did nothing more than any mother would have done – she helped her ex-husband and father of her children get a car in 2004 by co-signing the loan and she did not object when her ex-husband let their adult son Joseph use the car. She drove the car only once, and it was stored at her ex-husband's home.

In April 2006, Joseph was arrested in the car and the police towed it to an impoundment lot. As a result, the lender on the car loan – American Honda Finance – repossessed the car based on fine print in the loan agreement. American Honda reported the repossession to the credit bureaus but failed to report that the repossession was based on a police seizure and that neither Krajewski nor her ex-husband had failed to make any of the payments due under the loan.

Despite this heavy-handed treatment, Krajewski even tried to do the right thing by taking a loan from a finance company to pay off American Honda. Because of the black mark on her credit report, however, she was unable to get the financing.

Krajewski tried to tell her side of the story by sending a dispute to TransUnion in October 2006 stating that American Honda's report of a repossession on her credit report was incorrect because she had never missed a payment on the car loan, the car was improperly repossessed, and there was no default on the loan. But TransUnion did not listen.

Instead, TransUnion sent American Honda an ACDV that unhelpfully explained “[c]laims company will change. Verify all account information.” The ACDV did not ask American Honda to verify payment history in response to Krajewski's assertion that she had not paid late on the account. The ACDV did not mention that Krajewski claimed the repossession report was incorrect because it was really a police seizure caused by her son.

American Honda, of course, merely compared the information on the ACDV to its own computer records

³⁵ Ruffin-Thompkins v. Experian Info. Solutions, Inc., 422 F.3d 603, 610-611 (7th Cir. 2005).

and verified all information as accurate. Krajewski filed a second dispute in January 2007, with the same result.

So despite the fact that she never missed a payment on the Honda loan, almost never drove the car, didn't even garage the car at her home, and the "repossession" was the result of her adult son being arrested in the car, Krajewski was forced to file a lawsuit to remove the erroneous information on her credit report that she was the subject of a repossession and thus not creditworthy. Krajewski did nothing more than help her ex-husband (and American Honda) by co-signing to loan to make sure it was paid – which it was – and her reward was a ruined credit record that she could not get fixed without a lawsuit.

C. OF CLERKS AND AUTOMATONS

The role of the credit bureau employees allegedly assigned to “investigate” credit reporting disputes is extremely limited. Both the internal handbooks of the credit bureaus and evidence in FCRA lawsuits indicate that the primary job of these employees, or in some cases outsourced vendors, is no more than selecting the appropriate dispute codes sent to the furnisher.

For example, TransUnion’s dispute processing manual instructs its employees or vendors in relevant part:³⁷

1. Identify the Line item. (“[I]dentify the tradeline.”)
2. Open the Disputes Screen.
3. Add Claim Code(s). (“Based on the information the consumer provides, select a Claim Code from the Claims drop-down list and chose Add.”)
4. Add Consumer Comment. (“Add a Consumer Comment if the consumer provides additional details about the dispute that is not addressed by the current Claim Codes.”)³⁸
5. Select an Address. (“If the subscriber/data furnisher has more than one address....The CDV will be sent to the displayed address.”)
6. Finish opening the Dispute. (“Choose ‘Done.’”)

What is of course missing from this procedure is the exercise of any discretion by the bureau employee or outsource vendor. TransUnion’s procedures were further elaborated upon in this deposition of an employee who performed dispute processing before her job was outsourced to a vendor in India:³⁹

Q. [If the] consumer says, ‘I dispute this credit card account, here’s the account number, it belongs to my husband, not to me, what would you

³⁶ Krajewski v. American Honda Finance Corp., 557 F.Supp.2d 596, 614 (E.D. Pa. 2008).

³⁷ “Consumer Disputes,” TransUnion CRS Manual, Sept. 28, 2004, at 1-4, as cited in Leonard Bennett Testimony at 24-25.

³⁸ This Consumer Comment field, also called the “FCRA Relevant Information” field, is used infrequently, as discussed in Part III.F.

³⁹ Deposition of Selena Bazemore, Mullins v. TransUnion, Civ. Ac. No. 3:05cv888, Sept. 21, 2006, as cited in Leonard Bennett Testimony at 25-26.

have done if you were complying with TransUnion's procedures in August '05?

A. I would dispute the account with the appropriate claim code.

Q. How would you do that?

A. In the computer. [. . .] I would click on the account and select the appropriate claim code. Once you hit okay, it says open, which means the dispute on that account has been opened.

Q. After you put the dispute code and click on the dispute, do you have any other role in the investigation or dispute process for that account?

A. No.

Q. It just gets sent onto the creditor, and your job as to that dispute is done, right?

A. Correct.

Q. It would be fair to say that if you were complying with TransUnion's policies, you're not as an investigator or as a dispute processor making any judgment calls or exercising any discretion about whether a consumer really owns the account? [. . .] You're not exercising that discretion?

A. No. [. . .]

Q. How does TransUnion instruct its employees to process the dispute?

A. In the system.

Q. By taking the consumer's dispute, summarizing it into a claim or dispute code, inputting that into the system and sending that code to the creditor?

A. Correct.

Q. Is there any other part of an investigation besides that that TransUnion has instructed its employees is required?

A. No.

Equifax's procedures are substantially similar. In a March 2007 deposition, Equifax's Vice President of Global Consumer Services described that bureau's "reinvestigation" process accordingly:⁴⁰

Q: What knowledge do you have as to the mechanics of how a DDC Filipino employee would process an Equifax dispute? [. . .]

A: The electronic image would be displayed on their screen. They would have an ACIS [Automated Consumer Interview System] screen that they would use. They would then look at the electronic image. They would read off the identifying information, enter [. . .] that ID information into the system, access that credit report. At that point, they'd be able to determine if they were looking at the correct file. If they were, they'd go further. They'd read the letter, they gain an understanding of the issues at hand, and they'd look at the credit report to see if the credit report at that time reflects that. If it does, they would send those particular items to the

⁴⁰ Deposition of Gary Poch, Faile v. Equifax, Civ. Ac. No. 3:06cv617, March 13, 2007, as cited in Leonard Bennett Testimony at 22-23.

data furnisher or furnishers. They would request that an investigation be started.

[. . .]

Q: Right. But they're not -- they're not going to handle whatever response the creditor may provide?

A: That's correct.

Q: Do DDC employees have telephones on their desk?

A: I do not believe so.

Q: As part of their compliance with Equifax's procedures, do DDC's employees telephone consumers as part of conducting a reinvestigation?

A: They do not.

Q: Do they telephone creditors, the furnishers, as part of conducting a reinvestigation?

A: They do not.

Q: Do they telephone anybody from outside DDC or Equifax as part of conducting a reinvestigation of a consumer dispute?

A: They do not.

Q: What about e-mailing any of those non-Equifax, non-DDC people, creditor, consumer, or third party?

A: They should not be -- they do not e-mail them.

Q: And what about fax machines?

A: [. . .] They do not have fax machines either.

Q: Under what circumstances will a DDC employee forward the consumer's actual dispute letter or documents the consumer provided to the furnisher, the creditor, as part of a reinvestigation?

A: A mechanism does not exist to forward the actual documents.

As this deposition shows, the only human intervention by the credit bureau's employees is to determine the appropriate two-or-three-digit code to enter in a computer message to the creditor. No independent discretion is exercised. No information is "considered" in the investigation. The credit bureau's employees or vendors only action is to transfer the consumer's written dispute, of whatever detail, into a dispute code. In fact, other than the unusual and rare "VIP" disputes handled by the credit bureau attorneys or legal support, there is not even human contact between the furnisher and the creditor source.

Experian's procedures are no more rigorous than those of TransUnion or Equifax. Its employee testified:⁴¹

Q. After you receive a dispute such as Exhibit 1 [a multipage dispute letter with nearly 60 pages of supporting documentation], if you were following Experian's mandate or requirement, you would plug the

⁴¹ Deposition of Brenda Hahlen, Beck v. Experian, Civ. Ac. No. 1:05CV347 (E.D. Va.), June 29, 2005, as cited in Leonard Bennett Testimony at 26.

information into the computer, the name, address and social, and pull up the file on the screen, correct?

A. Yes.

Q. You would then review to learn what items were being disputed, is that correct?

A. Yes.

Q. What is the next step that you would follow if you were obeying Experian?

A. I would process the items. [. . .] I highlight on the [tradeline] item, and I enter the option. [. . .]

Q. What options do you have to choose from?

A. I would choose the one ‘the consumer states the item is not theirs due to fraud.’

Q. So there is a list of multiple choice options that you would click on?

A. Yes. [. . .]

Q. And can you list some of the other multiple choice codes you could click on?

A. [After estimating that there were as many as 15 dispute codes] There’s one for ‘not mine, for mixed file.’

What these depositions and internal credit bureau documents show is that their employees are no more than data entry clerks in the dispute and investigation process. None of the credit bureaus permit these clerks to consider and exercise discretion over a consumer’s dispute. When an Experian credit bureau witness was asked during another deposition, “What does Experian intend for its employees to do in order for them to obtain and review copies of the underlying documents on the dispute – from the creditor on the disputed account?,” the employee testified, “It’s not Experian’s policy to require or suggest that its agent ask for any underlying documents. Experian doesn’t train its employees to do handwriting analysis or various other investigative-type things that would be required of reviewing a credit application.”⁴²

Internet disputes involve even more automation, as there is usually no involvement of the credit bureau’s personnel in the dispute process. The internet dispute forms provide a list of on-line check-boxes to select as the basis for the dispute. The check-box selected by the consumer is matched to one of the pick-list ACDV dispute codes and automatically sent to the furnisher without any human intervention.

⁴² Deposition of Kimberly Hughes, Beck v. Experian, Civ. Ac. No. 1:05CV347 (E.D. Va.), June 30, 2005, as cited in Leonard Bennett Testimony at 26-27.

D. FURNISHERS' INADEQUATE INVESTIGATION

As if the automated and perfunctory nature of the e-OSCAR system were not bad enough, furnishers contribute to the problem by conducting inadequate investigations. Often, furnishers will merely verify the existence of disputed information, instead of actually investigating the dispute. They will not actually research the underlying dispute, review documents, or speak to consumers about the dispute. Instead, these furnishers simply confirm that the information in the ACDV matches their computer records, and then verify the disputed information to the credit bureaus.

*Linda Johnson*⁴³

The seminal FCRA decision establishing the legal duties of a furnisher in an FCRA dispute involves the credit card lender MBNA. Until its acquisition by Bank of America, MBNA was one of the top ten credit card lenders in the country. In *Johnson v. MBNA*, the company wrongfully attempted to hold Linda Johnson liable for the credit card debt of her ex-husband by reporting the debt on her credit report. Johnson had never signed up to be responsible as a joint account holder on her ex-husband's account. Instead, her ex-husband had merely authorized her to use his card when they were married.

Johnson sent dispute after dispute to the credit bureaus trying to get her ex-husband's delinquent MBNA account off her credit report. Frustrated, she finally sued MBNA and the credit bureaus. During the course of the litigation, MBNA's employees testified that the company's FCRA investigation process consisted of merely confirming the name and address of consumers in the MBNA computers and noting from the applicable codes that the account actually belonged to the consumer. The employees revealed that they *never* consulted underlying documents such as account applications to determine accuracy of disputed information.

More appalling was the fact that MBNA argued these perfunctory checks for data conformity were all that the FCRA required of furnishers in an investigation. MBNA claimed that it was not required to review the ex-husband's original account application, which would have shown whether Johnson had really signed on the dotted line or merely been added as an "authorized user." In fact, MBNA revealed it didn't even keep the original account application after 2 years. Query how MBNA would have investigated an identity theft case if it refused to review the original signed application or had even discarded it?

Fortunately, the Fourth Circuit disagreed with MBNA. The court held:⁴⁴

The key term at issue here, "investigation," is defined as "[a] detailed inquiry or systematic examination." ... Thus, the plain meaning of "investigation" clearly requires some degree of careful inquiry by creditors.... It would make little sense to conclude that, in creating a system intended to give consumers a means to dispute-and, ultimately, correct-inaccurate information on their credit reports, Congress used the term "investigation" to include superficial, unreasonable inquiries by creditors. We therefore hold that [the FCRA] requires creditors, after receiving notice of a consumer dispute from a credit reporting agency, to conduct a reasonable investigation of their records to determine whether the disputed information can be verified.

⁴³ *Johnson v. MBNA*, 357 F.3d 426 (4th Cir. 2004).

⁴⁴ *Id.* at 430-431 (citations omitted).

Other lawsuits reveal that MBNA is not alone in conducting superficial investigations. Other furnishers with similarly perfunctory FCRA investigative procedures include:

- **Capital One** – Capital One is one of the top 10 credit card lenders in the country. Its employee Pamela Tuskey described how all three of the national credit bureaus instructed Capital One personnel to simply verify information and to “make our system look like your system.” The credit bureaus even discouraged the Capital One personnel from actively researching by pulling statements or similar activities.⁴⁵
- **Debt Collectors/Buyers** – The *King v. Asset Acceptance* case in Part II.D, describes how this debt buyer “investigates” FCRA disputes by merely comparing the account information in ACDV with the information in Asset's files. According to the information revealed in the *King* case, Asset does not even obtain account documents from the original creditor.⁴⁶

Asset Acceptance is not alone among debt buyers. The FTC took enforcement action against another debt buyer, Performance Capital Management (PCM), alleging that it failed to conduct “investigations” within the meaning of the FCRA because:⁴⁷

“When PCM receives consumer dispute verification notices, it is the practice of PCM to compare the name, address, and information in PCM's computer database with the information provided on each consumer dispute verification form. Where the two match, PCM reports that it has verified as accurate the information in its files. The actual records of the original creditor are not reviewed, nor is the matter referred to the original creditor for the original creditor to verify the accuracy of the information.

- **Mortgage Bankers** - Trade groups for certain furnishers/creditors have asserted the same argument as MBNA – that if a credit report reflects what is in the furnisher's records, it should be considered “accurate,” no matter whether the furnisher's records are objectively accurate as a matter of reality. For example, the Mortgage Bankers Association has urged regulators to define accuracy as “accurate reporting of the status of the account as reflected in the furnisher's records.”⁴⁸

⁴⁵ Deposition of Pamela Tuskey, *Carol Fleischer v. TransUnion*, Case No. CV 02-71301 (E.D. Mich.).

⁴⁶ *King v. Asset Acceptance*, 452 F.Supp.2d 1272 (N.D. Ga. 2006).

⁴⁷ Complaint, *U.S. v. Performance Capital Management* (Bankr. C.D. Cal. 2000), available at <http://www.ftc.gov/os/2000/08/performcomp.htm>.

⁴⁸ *Comments of Mortgage Bankers Association re: Interagency Advanced Notice of Proposed Rulemaking: 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*, May 22, 2006, at 4.

Some furnishers are even worse. Apparently, they do not even bother to make sure they have reviewed *all* their records when they take the perfunctory step of checking that the information in their database matches the information in the ACDV.

*The Robertsons*⁴⁹

Danny and Gay Robertson opened a J.C. Penney credit card account in 1978. Many years later, the Robertsons' account ended up at GE Money Bank, with a balance of \$222.22. In October 2004, GE called the Robertsons to collect the balance. The Robertsons paid off the balance over the phone using their debit card. GE even gave the Robertsons a confirmation number, and its own internal records showed that this payment was made.

However, GE failed to post the Robertson's payment to their account. GE attempted to collect the balance on the account several more times. Each time, the Robertsons informed GE that they had paid off the account by debit card.

GE eventually charged the account off as bad debt and assigned the account to a debt collector. The debt collector reported the account to the credit bureaus as "in collections." When the Robertsons realized this account was showing up negatively on their credit reports, they sent detailed dispute letters to TransUnion, Equifax, and GE.

The Robertson's dispute letters to the three bureaus stated clearly that they had paid off the account. TransUnion sent an ACDV to GE on September 29, 2005. GE sent a response back *on the very same day* verifying that the account had been charged off as bad debt, despite information in its own records that a payment had been made.

Equifax sent GE an ACDV on October 4, 2005. Again, GE verified the account as charged off, this time waiting a day to do so. GE did not conduct any investigation into its own records except to verify identity information.

The use of automation by the credit bureaus contributes to the problem of furnishers conducting superficial investigations. The ACDV codes fail to provide a meaningful description of the dispute and underlying documentation - furnishers have even complained that the dispute codes are "vague and overbroad."⁵⁰ The e-OSCAR system makes it all too easy for a furnisher to simply check a box indicating that the disputed information has been verified, an exercise that aids and abets perfunctory investigation.

E. PARROTING: THE CREDITOR AS GOD

After the furnisher responds to an FCRA dispute, the credit bureaus main response is to "parrot" what the furnishers report to them. They will accept the results of the furnisher's "investigation" even when a simple check would reveal inconsistent information. In other words, the credit bureaus' policies are that what the furnisher says is gospel and even court records cannot contradict that.

⁴⁹ Robertson v. J.C. Penney Co., 2007 WL 623397 (S.D. Miss. Mar. 4, 2008).

⁵⁰ FTC/FRB FCRA Dispute Process Report at 17.

For example, the case of *Allen v. Experian Information Systems* involved a Sears account that was being reported on the consumer's credit report as being "included in bankruptcy" past the limitations period for that information. The consumer's bankruptcy had occurred in 1993, which was reflected in the section of the consumer's report that listed public records information. Yet the Sears account was reported as being part of a bankruptcy that occurred in 1997. During a deposition, the consumer's attorney asked Experian employee Kathy Centanni why Experian did not address the consumer's dispute by cross-checking Experian's own records or checking the records of the United States Bankruptcy Court as to the correct date of the bankruptcy. Ms. Centanni answered:⁵¹

...the consumer is not disputing the bankruptcy. If they were disputing the bankruptcy as such, we would dispute the public record.

The consumer is disputing the information being reported by a creditor, and it's our responsibility to go back to that creditor for them to research it.

In other words, Experian's policy was to defer to what the furnisher responded, even when court records and its own files contradicted that response.

Indeed, in case after case, the credit bureaus have refused to conduct their own investigation and instead simply "parroted" the furnisher. Recent examples include:

- *Cairns v. GMAC Mortg. Corp.*, 2007 WL 735564 (D. Ariz. March 5, 2007). Equifax argued that "by contacting GMAC regarding Mr. Cairns' dispute, it had complied with the statutory obligations regarding reinvestigation."
- *Murphy v. Midland Credit Mgmt.*, 456 F.Supp.2d 1082 (E.D. Mo. 2006). The court rejected Experian's argument that an investigation solely consisting of ACDVs without seeking additional documentation was reasonable as a matter of law.
- *Saenz v. TransUnion, LLC*, 2007 WL 2401745, *7 (D. Or. Aug. 15, 2007). In this case, the court noted: "TransUnion argues that use of ACDV procedures is necessarily reasonable [in an investigation] TransUnion buttresses its arguments with the assertion that creditors are better situated than reporting agencies to determine the accuracy of disputed information. TransUnion's argument rests upon a significant mischaracterization of its duties under the FCRA."

Another excerpt of the deposition of TransUnion's employee who performed dispute processing before such tasks were outsourced to a vendor using workers in India revealed how the credit bureaus entirely defer to the furnisher in disputes:

Q. What if the creditor and the consumer strongly disagree about whether a debt is owed, consumer says that the debt's not owed, the creditor says yes, it is, what does TransUnion do to determine who's correct?

⁵¹ Deposition of Kathy Centanni, *Allen v. Experian Information Solutions*, Civ. No. 04-817 (S.D. Ill. Dec. 6, 2005).

A. It's up to the creditor to make the decision.⁵²

Thus, if the creditor instructs the credit bureau to retain the information as reported, there is almost nothing the consumer can do to override that instruction.

While the credit bureaus claim that they will review the documents the consumer provides to determine if they are "acceptable" to allow a correction outside the ACDV process, this is actually a very narrow category of documents. Essentially, for a consumer's dispute of a credit account, the only "acceptable" documents for TransUnion are written letterhead communications from the creditor itself instructing TransUnion to delete or correct the reported account.⁵³ Further, the creditor letter would have to be more recent than the last date the creditor had otherwise "verified" the account. CSC Credit Services, which is an Equifax affiliate, has explicitly stated its policy of not considering any payoff letter from a creditor over 90 days old.⁵⁴

*June Betts*⁵⁵

In 1998, a Cadillac was abandoned at the side of the road. Law enforcement officials had the vehicle towed, and it was sold at auction. The auction proceeds didn't cover the towing company's fee, so the difference was assigned to Topco, a debt collector.

Topco found a vehicle seller's report on file with the Washington State Department of Licensing with the name of June Baker as the buyer. June Baker was June Betts's maiden name, and the report had her address on it, but Betts claimed she never owned the Cadillac. Despite her protestations, in January 2001, Topco sued Betts in King County District Court. Betts won that lawsuit, and the court issued a judgment finding her not liable for the towing fee.

Topco also reported the towing debt on Betts's credit report. On February 13, 2001, Betts sent a notice to Equifax disputing the debt. Equifax sent a CDV to Topco, which simply updated Betts's address and confirmed the debt. Betts's made a second dispute, and Topco received another CDV on March 20, 2001. Topco again verified the debt. This time, Topco even increased the amount it claimed was owed, from \$488 to \$829. Equifax simply listed this new information, accepting Topco's decision. This was despite the fact that Betts had won Topco's lawsuit against her, and she had a court judgment holding that she was not responsible for the debt.

F. "ALL RELEVANT INFORMATION"

As part of a credit reporting investigation, the FCRA contains an explicit and key requirement that the credit bureau include in the notice of dispute to the furnisher "all

⁵² Deposition of Selena Bazemore, Mullins v. TransUnion, Civ. Ac. No. 3:05cv888, Sept. 21, 2006, as cited in Leonard Bennett Testimony at 25-26.

⁵³ "Documents Acceptable for Maintenance," TransUnion CRS Manual, Sept. 28, 2004, at 1-4, as cited in Leonard Bennett Testimony at 25.

⁵⁴ McKinley v. CSC Credit Serv., 2007 WL 1412555 (D. Minn. May 10, 2007).

⁵⁵ Betts v. Equifax Credit Information Services, 245 F. Supp. 2d 1130 (W.D. Wa. 2003).

relevant information” provided by the consumer.⁵⁶ However, as discussed in Part III.B, when a consumer sends a dispute to the credit bureau, the bureau will reduce the dispute, no matter how detailed, substantive or documented, to one of the handful of two or three digit dispute codes used by the e-OSCAR system. The bureau will not send the furnisher any of the supporting documentation provided by the consumer, such as account applications, billing statements, letters, and payoff statements – documents that could show overwhelming and even conclusive proof of the consumer’s dispute.⁵⁷ The bureaus’ refusal to forward all relevant documents and details of the dispute appears to be in clear conflict with the dictates of the FCRA.

Not only have consumers and their attorneys complained of this failure to forward documents, this has also been a matter in contention between the FTC and the credit bureaus. Yet unfortunately, the FTC and Federal Reserve Board have decided not to universally condemn the bureaus’ failure to provide furnishers with the supporting documentation submitted by consumers. Instead, the FTC and Fed have stated that “[b]y itself, however, this does not mean that [credit bureaus] fail to convey ‘all relevant information’ to furnishers,” but that “in certain situations, the failure to convey the actual documents may lead to incorrect outcomes.”⁵⁸ And despite even this concession that the failure to forward documents may lead to incorrect outcomes in some cases, the FTC and Fed apparently have not taken any action to require the credit bureaus to improve their procedures.

The credit bureaus claim that forwarding documents through e-OSCAR is “questionable,” a difficult claim to believe given how easily documents can now be transmitted electronically. First, all three national bureaus scan and archive the consumer’s dispute and documents. There is no greater storage space required. There is also no technological obstacle to forwarding the dispute and documents electronically. Equifax and TransUnion already do so to India and the Philippines. Sending them concurrently to domestic furnishers would not require any more resources.

The credit bureaus’ response to criticism over their failure to forward documentation is to rely on a field in the ACDV form that permits a “free text” comment to be entered by the credit bureau clerk, which is called the “FCRA Relevant Information field.” This box is limited to one line and a fixed number of characters. The credit bureaus’ procedures manuals offer almost no instructions for their clerks as to what information should be placed in this one-line text field.⁵⁹ As a result, only a minority of ACDVs sent by the bureaus actually contain such a field. The credit bureaus have admitted that this field is used in only 30% of disputes processed through e-Oscar.⁶⁰ TransUnion’s employee has testified that it is used less than 10% of the time and even

⁵⁶ 15 U.S.C. § 1681i(a)(2).

⁵⁷ FTC/FRB FCRA Dispute Process Report at 18.

⁵⁸ FTC/FRB FCRA Dispute Process Report at 33-34.

⁵⁹ Leonard Bennett Testimony at 21.

⁶⁰ FTC/FRB Report at 17.

then only if the consumer's dispute is not in a regularly selected category.⁶¹ In other words, if the employee is able to categorize the dispute into one of the two or three digit codes, the text field is apparently not used to convey additional information that might help resolve the dispute.

*Michael Karmolinski*⁶²

The case of Michael Karmolinski demonstrates how inadequate the "FCRA Relevant Information" field can be in informing the furnisher of a dispute, as compared to the consumer's actual notice letter and supporting documentation.

In March 2001, then-19 year old Karmolinski opened a credit card account with Associates Credit Card, a lender later acquired by Citibank. He lost his job, and fell behind on paying a \$1,000 debt. Associates charged off the debt and sent it to Enterprise Recovery Systems (ERS), a debt collector, in December 2001. Karmolinski made arrangements to pay off the debt, with a final payment of \$508 in June of 2002.

Karmolinski paid off the debt, but Citibank reported to the credit bureaus that Karmolinski still owed a past due balance on the account. As a result, Karmolinski was unable to guarantee his wife's car loan, and was denied other credit. He contacted ERS, which gave him a letter dated May 2003 stating that he paid off the Associates account in June 2002.

After pulling his credit report in April 2004 and seeing that Citibank was still reporting a past due balance, Karmolinski sent disputes to TransUnion in April 2004 and September 2004. With the first dispute, he included a copy of the check paying off the account. With the second dispute, he included the May 2003 letter from ERS. Neither document was sent to Citibank.

Instead, TransUnion sent to ACDVs to Citibank asking it to verify various information such as account balance and original loan amount. TransUnion never mentioned that Karmolinski had asserted the account was paid off and had documentation in support of his assertion. In fact, TransUnion told Karmolinski that it could not accept the May 2003 ERS letter, because it was over a year old and not from Citibank, despite the fact that ERS had been working on behalf of Associates/Citibank. Instead, the September 2004 ACDV merely stated in the free form box "[c]laims company will change. Verify all account information" – a very unhelpful explanation and certainly not "all relevant information" about the dispute in comparison to the actual payoff letter from ERS.

Of course, Citibank verified the past due balance on the account in response to both ACDVs. Karmolinski filed a lawsuit when he received notice of the second verification on October 6, 2004. A few weeks later, the delinquent account was deleted from his credit report.

The credit bureaus' failure to forward the consumer's documentation has a real and significant impact on consumers. Often, it strips them of their rights to force furnishers to conduct the very investigation on which the bureaus defer. Several federal courts have dismissed consumer claims against furnishers because of the generality of the

⁶¹ Deposition of Eileen Little, Mullins v. TransUnion, Civ. Ac. No. 3:05cv888, Sept. 21, 2006, as cited in Leonard Bennett Testimony at 28.

⁶² Karmolinski v. Equifax Information Serv., 2007 WL 2492383 (D. Or. August 28, 2007).

bureaus' ACDVs and failure to forward the actual dispute and documents. For example, the Seventh Circuit held in one case:

Credit Control's investigation in this case was reasonable given the scant information it received regarding the nature of Westra's dispute. Credit Control received a CDV from TransUnion indicating that Westra was disputing the charge on the basis that the account did not belong to him. The CDV did not provide any information about possible fraud or identity theft or include any of the documentation provided to TransUnion by Westra. Credit Control verified Westra's name, address, and date of birth and sent the CDV back to TransUnion. Had TransUnion given Credit Control notice that the nature of the dispute concerned fraud, then perhaps a more thorough investigation would have been warranted.⁶³

G. BURDEN OF PROOF

The result of the broken credit reporting system is that the burden of proof has effectively shifted from the creditor or debt collector to the consumer. Creditors and collectors are allowed to take action against consumers without being required to justify their contentions. Consumers now have the burden to prove a negative - that they do not owe a debt – and are rebuffed when they attempt to do so. When they fail because they deck is stacked against them, the creditor or collector will continue to report the consumers as liable. In fact, in litigating the Johnson v. MBNA case discussed in Part III.D, Ms. Johnson's attorney learned from MBNA's account records that the consumer was expressly told, "It is not our burden to prove you owe the debt. It's your burden to prove you do not."⁶⁴

For debt collectors, the credit reporting system alleviates them from the need to prove in a court of law by a "preponderance of the evidence" that a consumer is liable for a debt, and that the amount of the debt is correct. Instead, the debt collector simply places the black mark on the consumer's credit report, and waits until the consumer needs to buy a car or home or insurance coverage. The consumer is either forced to pay off the amount to improve her credit report or forced to pay higher prices (if he or she can get the credit or insurance at all).

For consumers to get errors in their credit reports fixed, they must dispute multiple times and in some cases retain a lawyer to file a lawsuit. Consumers who do not have the time, educational skills, and resource to send multiple disputes, like the single mother of twins in the FTC study, are simply out of luck – plagued by a Scarlet "F" of credit that they did not cause but cannot get fixed. And even those who manage to send multiple disputes cannot always get justice without being able to find an attorney experienced in litigating credit reporting disputes.

⁶³ Westra v. Credit Control of Pinellas, 409 F.3d 825 (7th Cir. 2005); Malm v. Household Bank, N.A., 2004 U.S. Dist. LEXIS 12981 (D. Minn. July 7, 2004).

⁶⁴ Leonard Bennett Testimony at 14.

*Victoria Apodaca*⁶⁵

Victoria Apodaca was a schoolteacher in New Mexico trying to buy a house. To her horror, she discovered her Equifax credit report stated she had filed for bankruptcy and had several accounts that were reported as past due. Apparently, Apodaca's credit files had become mixed in with that of Victoria Lopez Apodaca, because they had the same last and first name, seven of the nine digits in their Social Security numbers matched, and they both resided in the state of New Mexico.

Apodaca sent her first dispute to Equifax in June 2003, without satisfaction. She continued to contact Equifax, including sending another dispute on August 12, 2003, which included the bankruptcy petition of Lopez Apodaca and pointing out the different Social Security numbers between the two. Apodaca also mentioned that these errors were preventing her from purchasing a home that she was supposed close on August 15. She noted that she had sent in other written disputes with copies of her driver's license number and paystubs. Even with this clear documentation, Equifax did not fix Apodaca's credit report.

Apodaca sent another dispute in October 2003, again with copies of her driver's license and Social Security card. This dispute also pointed out several accounts that were not hers, including a GMAC and Discover Financial Account. Apodaca sent a final dispute on April 2004, again including a copy of Lopez Apodaca's bankruptcy petition and stating that the GMAC and Discover accounts were not hers. The bankruptcy and GMAC account was finally deleted, but not the Discover account. Frustrated, Apodaca resorted to filing a lawsuit. Only then did Equifax delete the Discover account.

During the lawsuit, Equifax claimed that its policy was to delete information from a credit report if the consumer provides "acceptable" documentation. The bureau apparently did not consider copies of the actual petition filed by Lopez Apodaca in a United States Bankruptcy Court to be "acceptable".

Instead, Equifax contracted with a company called Choicepoint to review the bankruptcy court records, and sent a CDV with the code "Not his or hers, please provide complete ID." Equifax did not send Apodaca's dispute or the copies of the bankruptcy documents. Choicepoint reviewed the bankruptcy court's records, but failed to notice the difference in Social Security numbers. As a result, Choicepoint verified the bankruptcy information on Apodaca's report as correct.

The fact that Choicepoint did not notice the difference in Social Security numbers was the direct result of the automated CDV system and Equifax's failure to provide Apodaca's dispute to its vendor. As the court noted, "if Equifax had forwarded copies of all the information supplied by Plaintiff to a competent investigator or public-records vendor instead of simply reducing all of that information to a three-digit code on its standardized CDV form, it is reasonable to infer that the mixed-file situation could have been corrected more promptly."

⁶⁵ Apodaca v. Discover Fin. Servs. 417 F.Supp.2d 1220 (D.N.M. 2006).

IV. THE ECONOMICS OF CREDIT REPORTING

A. WHO IS THE CUSTOMER

While critically important to consumers and the national economy, the credit reporting industry is unlike most other industries in some fundamental respects. It is essential to understand that the paying clients of the credit reporting industry are not consumers, but the creditors who furnish or use the information contained in the credit bureaus' databases. Despite the growing profits in credit monitoring services, the credit bureaus make most of their money from furnishers. For example, discovery in lawsuits uncovered the fact that TransUnion had received over \$6 million per year from MBNA alone.⁶⁶

Moreover, consumers have no say in whether their information is included in the credit bureaus' databases. Most Americans cannot avoid having a credit history. Unless they are very wealthy, consumers need to borrow money if they want to buy a house or attend college. Credit reports are also used in other essential aspects of life, such as insurance and employment. Thus, unlike almost all other business relationships, consumers who are unhappy with the actions of a credit bureau cannot vote with their feet – they cannot remove the information or take their business elsewhere.

Creditors, in contrast, do have the ability to switch between credit bureaus if they wish. Furthermore, vigorous investigation of consumer disputes is likely to drive creditors away. The creditor who reports a delinquent account to the credit bureaus does so in the hope of collecting that debt. Credit bureaus have no interest in deferring to a consumer involuntarily captured in a relationship with the bureau, when doing so could cause its paying customer to lose collection opportunities and profits. Both furnishers and credit bureaus also benefit from a system that allows them to spend only seconds on a dispute rather than the time (even if minimal) required to actually resolve it.

Thus, traditional competitive market forces provide little incentive for credit bureaus to incur the costs of instituting new procedures that ensure information is accurate or to undertake investigations to correct errors, since these activities primarily benefit consumers. Only the FCRA itself compels such behavior.

However, the risk of an occasional FCRA lawsuit appears not to have overcome these economic incentives. The result is persistent inaccuracies in credit reports, which harm both consumers and creditors. Until the failure to conduct a real investigation becomes more expensive than the savings from these cost reducing measures, the current system will remain broken. Furthermore, any protections for identity theft victims cannot be effective in the absence of a real investigation.

⁶⁶ Leonard Bennett Testimony at 30.

B. FAR AND AWAY

Another factor in the inadequacy of credit reporting investigations is that two of the three national credit bureaus have outsourced these tasks to vendors who use workers in foreign countries. While there are many policy issues concerning the offshoring of jobs that are beyond the scope of this report, an important concern from a credit reporting perspective is that a worker in another country is not as likely to understand the American credit system. In addition, foreign companies may be governed by a different set of privacy rules than U.S. law provides.

Of the three national credit bureaus, only Experian processes consumer disputes domestically. TransUnion receives disputes at its consumer relations facility near Philadelphia, scans the dispute into an electronic image and then transmits the image to Intelenet, its subcontractor located in Mumbai, India.⁶⁷ Intelenet in Mumbai can connect directly to TransUnion's CRONUS database, retrieve a consumer's credit file and initiate the ACDV exchange.

Equifax uses a number of outsource vendors for its dispute processing. Consumer disputes are imaged by Innasource, based in Atlanta.⁶⁸ A record of the dispute is logged into the consumer's file, and the dispute is then electronically transmitted to Jamaica, the Philippines, or Costa Rica.⁶⁹ The foreign contractor accesses Equifax's database, retrieves the consumer's credit file and initiates the ACDV exchange as applicable. The results of the ACDV exchange are then automatically reflected back into the consumer's credit files.⁷⁰

C. QUOTAS

As discussed in Part IV.A, there is little economic incentive to conduct true investigations, because they do not produce revenue. Real investigations would cost the credit bureaus and furnishers real money. For the credit bureaus, this is money spent on people who are not their real customers. For furnishers, this is an investigation that could undermine their debt collection efforts.

Thus, until recently with the move of E-Oscar into a for-profit entity, the investigation function has been seen only as a cost burden, to be minimized and reduced as much as possible. As part of this cost reduction, litigation discovery has revealed quota systems used by the credit bureaus to force employees to process disputes rapidly and without meaningful inquiry. For example, Experian uses a system to measure the number of "converted units" produced by each employee.⁷¹ Each task is assigned a different value. To meet Experian's minimum standards for a pay incentive if processing

⁶⁷ Leonard Bennett testimony at 22.

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ Deposition of Kimberly Hughes, Beck v. Experian, Civ. Ac. No. 1:05CV347 (E.D. Va.), June 30, 2005, as cited in Leonard Bennett Testimony at 31.

the most difficult of disputes -- fraud and identity theft claims -- the employee would have to perform at least 98.25 disputes per day, or 13.1 per hour.⁷² The quota minimum at TransUnion before it outsourced its investigation functions was between 10 to 14 dispute letters per hour.⁷³ In other lawsuits, credit bureau employees have testified that employees are required to process one dispute every four or six minutes in order to meet quotas.⁷⁴

In fact, more recent litigation discovery has shown that the credit bureaus have driven costs even lower. Before mid-2004, when Equifax still handled some disputes in-house, its average cost per dispute was \$4.67.⁷⁵ By late 2004 and into 2005, Equifax was using an outsource vendor called ACS in Montego Bay, Jamaica. Its ACS investigations cost Equifax only \$1.08.⁷⁶ Now, after the move to DDC in the Philippines, Equifax pays only \$.57 per consumer dispute letter, regardless of how many items or accounts are at issue.⁷⁷ These dramatic reductions in cost per dispute described above have all come during a period of rising identity theft and fraud disputes.

TransUnion has a different contractual relationship with its outsource vendor. It pays the Indian company a flat \$8.00 per man-hour the vendor incurs, but it maintains rigorous production standards the vendor must meet.⁷⁸

To add insult to injury, the credit bureaus have found another way to reduce their cost burdens for investigations – by charging furnishers for investigations and actually making a profit from them. For example, Equifax pays its outsource vendor in the Philippines up to \$.57 to process each consumer dispute letter it receives. But through e-Oscar system, the bureaus charge no less than \$.25 to each furnisher for each ACDV dispute form sent electronically.⁷⁹ Thus, if a consumer disputes five inaccurate accounts after a file is mixed or an identity stolen, Equifax would pay its vendor a fraction of the gross amount (e.g. \$1.25) it charges its creditor customers through E-Oscar. In fact, the more automated disputes it sends out, the more money it generates.

This is as much “cost” information as consumers have yet discovered. In fact, in two recent cases, the credit bureaus claimed not to maintain budgets, projections or gross cost estimates for their investigation functions,⁸⁰ a claim that is fairly incredible.

⁷² *Id.*

⁷³ See Deposition of Eileen Little, *Evantash v. G.E. Capital Mortgage*, Civ. Action No. 02-CV-1188 (E.D. Pa. Jan. 25, 2003).

⁷⁴ See *Cushman v. TransUnion Corp.*, 115 F.3d 220, 224-25 (3d Cir. 1997). See also Deposition of Regina Sorenson, *Fleischer v. TransUnion*, Civ. Action No. 02-71301 (E.D. Mich. Jan 9, 2002).

⁷⁵ Leonard Bennett Testimony at 30.

⁷⁶ Deposition of Gary Poch, *Faile v. Equifax*, Civ. Ac. No. 3:06cv617, March 13, 2007.

⁷⁷ *Id.*

⁷⁸ Leonard Bennett Testimony at 30.

⁷⁹ *Id.* at 4.

⁸⁰ *Beck v. Experian*, Civ. Ac. No. 1:05CV347 (E.D. Va.), and *Faile v. Equifax*, Civ. Ac. No. 3:06cv617.

"VIP" Files

The problems with superficial and perfunctory investigation of credit reporting disputes may not affect certain people, such as an identified celebrity, regulator or government official. Each of the three national credit bureaus maintains a list of consumers they identify as "VIP" files. A TransUnion employee testified in a deposition:⁸¹

Q. And some references have been made in prior cases to maybe a VIP category. Is there such a category? [. . .] For example, if a lawyer makes a dispute, it's handled by your department?

A. That is correct.

Q. If a politician or [a person] known to be a politician makes a dispute, are those the types of disputes you might handle?

A. Yes.

Q. And celebrities as well?

A. Yes.

For obvious reasons, these files, which also include credit bureau employees, receive special treatment. They are handled by high level employees. In fact, for Equifax and TransUnion, a significant difference is that they are handled by a credit bureau employee actually located in the United States.

D. CREDIT REPAIR ORGANIZATIONS

Credit bureaus may attempt to justify the perfunctory FCRA investigation process as a response to frivolous disputes generated by credit repair organizations. Some of these organizations do deceptively market false promises to obtain the removal of otherwise accurate credit data. The Consumer Data Industry Association has estimated that 30% of the credit bureau disputes involve credit repair organizations.⁸²

However, trivializing all consumer disputes in the name of coping with credit repair disputes is throwing the baby out with the bathwater. Credit bureaus must assume that, as FTC guidance states, a consumer's dispute is bona fide, unless there is evidence to the contrary. The short-shrifting of legitimate substantive disputes may actually encourage more consumers to turn to credit repair organizations in their desperation.

Moreover, credit bureaus have already developed methods to spot credit repair disputes.⁸³ Credit repair disputes are often generic in nature, making a claim such as "This account is inaccurate" with nothing more, and thus easily separated from most legitimate disputes. Another hallmark of credit repair disputes is that they will dispute all negative information in a credit report without specific allegations concerning any of the

⁸¹ Deposition of Shontese Norwood, Mullins v. TransUnion, Civ. Ac. No. 3:05cv888, Sept. 21, 2006, as cited in Leonard Bennett Testimony at 5.

⁸² *Credit Reports: Consumers' Ability to Dispute and Change Inaccurate Information: Hearing before the House Committee on Financial Services*, 110th Congr. (2007) (statement of Stuart K. Pratt, President, CDIA), at 20, available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/ospratt061907.pdf.

⁸³ Some of these methods are described in Klotz v. Trans Union, LLC, 246 F.R.D. 208, 211 (E.D. Pa. 2007).

individual items. Other signs are disputes made using a common format, mass mailings with the same envelopes or postage, or disputes in which the consumer has included the cover letter and instructions from the credit repair organization.

A dispute bearing such hallmarks and unsupported by specific allegations or evidence, without more, is not entitled to an in-depth, meaningful investigation under the FCRA. In fact, the FCRA already permits a credit bureau to refuse to investigate disputed information if the bureau “reasonably determines” a dispute is frivolous or irrelevant.

The problem of frivolous credit repair disputes does not justify the credit bureaus’ failure to put appropriate resources into resolving legitimate disputes. Consumers whose disputes do not show the hallmarks of a credit repair dispute are entitled to a meaningful investigation, not a farce.

V. TIPS & RESOURCES

A. HOW TO DISPUTE ERRORS IN A CREDIT REPORT

While this report shows that the investigations conducted by the credit bureaus in response to disputes will usually be perfunctory, it is still important for consumers to dispute errors in their credit reports and to follow up with more disputes.

First, the furnisher may be willing to fix the error, either because the furnisher actually does find an error or to maintain good customer relations. Second, if the furnisher does not respond, the credit bureau is legally required to delete the disputed information from the consumer's credit report. Third, if the error is not corrected, the consumer has a potential legal claim under the FCRA – but ONLY if the consumer has sent a dispute to the credit bureau.

The following are some tips on sending a dispute to credit bureau. Even if the disputes themselves do not get results, these tips will ensure that the consumer preserves his or her legal claim under the FCRA.

1. Request a Investigation in Writing, Return Receipt Requested (Don't Use the Credit Bureau's Web Site)

Although not required by the FCRA, it is safest to request an investigation in writing (keeping copies of all correspondence), or to follow up a telephone request with a written confirmation. Telephone disputes do not create an adequate record in the event a consumer needs to follow up a failed dispute with litigation. In addition, the consumer will not be able to provide documentary support of the dispute by telephone. Furthermore, although the FCRA requires national credit bureaus to maintain a toll-free number for consumers, telephone access to the credit bureaus is not always consistent.

It is even advisable to send the request by certified mail, return receipt requested. Even though the consumer retains a mailing presumption, this may still leave her with a marginal claim. If the credit bureau can claim that it never received the dispute, it will argue that it merely made a mistake, rather than be forced to defend a claim that its procedures themselves are inadequate. Avoid using the internet to forward disputes, for some of the same reasons.

2. Don't Be Limited by Credit Bureau Request Forms

When consumers request copies of their credit reports from the national credit bureaus (Experian, TransUnion, and Equifax), they will receive a dispute form that they are encouraged to use. These forms attempt to pigeon hole the dispute into one of several general types, and do not facilitate a detailed consumer dispute. These forms provide a list of "check box" dispute choices, and appear to discourage a more substantive dispute. Consumers using such forms for a dispute should supplement the forms with additional

written details and documentary support. Internet disputes confine consumers to a similar list of check boxes, and thus should be avoided.

3. The Consumer Should Keep a File of All Communications

A request for investigation may be just the beginning of a protracted battle with the credit bureau that may ignore correspondence or fail to follow up as promised. Thus it is good practice for the consumer to establish a file of all correspondence sent to and received from the credit bureau, and to have proof that the credit bureau has received the consumer's correspondence. Similarly, the consumer should keep dated notes of all telephone calls.

4. Also Notify the Furnisher of the Dispute

Consumers at the same time should directly notify the creditor or other furnisher of the disputed information. The critical notice of dispute is directed to the credit bureau, which triggers the right to an investigation that the consumer can enforce. The bureau will then ask the furnisher to investigate. But also sending a detailed notice to the furnisher will forestall any arguments by the furnisher that the notice from the credit bureau was not adequate for it to conduct a reasonable investigation.

5. Send a Dispute at Least to All Three Major Bureaus

It is usually not enough to dispute an error at one credit bureau. Instead, the consumer should request a credit report from at least Experian, TransUnion, and Equifax, and dispute errors individually with each of the three companies. A furnisher supplying incorrect information to one of these agencies will often supply the same incorrect information to the other two. Moreover, correcting a consumer's file with one of these three does not lead to correction at the other two.

A more compelling need to contact more than one credit bureau can arise when the consumer is informed by a creditor (or other person) that adverse action was based on a credit report received from a credit bureau which is not one of the "Big Three," such as a reseller. While it is important to dispute the accuracy of information with the reseller who supplied it to the creditor, and while special rules require resellers to handle or forward the dispute, a consumer should also consider going straight to the "Big Three."

6. Be Careful How an Account Number Is Described

The dispute notice should adequately identify the consumer, fully identify the account or other item being disputed, and explain why it is disputed. Otherwise, the credit bureaus may take consumer disputes literally, and do nothing more than what is expressly requested.

If the consumer states, "I have never had a MBNA credit card, so delete MBNA account #1234," the credit bureau will only delete an account with that number, and not

other accounts the consumer may have with MBNA. This is a common problem because many furnishers change account numbers after an initial dispute is made. Correcting just the old account will not affect these new accounts. Other times, the account number the consumer sees in a periodic statement is different than the number used in the consumer's file at the credit bureau (or by a debt collector to which the debt is transferred).

To prevent these problems, an investigation request should describe the full range of accounts the dispute covers. For example, "I have never had a MBNA credit card. Any MBNA account in my credit file is not mine and should be deleted. This includes account number 1234, as well as any other account you may be reporting, as well as any account that may be reported by any debt collector who is reporting a debt originating from a MBNA account." For First USA accounts, which became Bank One and then Chase accounts, a consumer could state, "I am disputing the First USA account #2345. It may also be reported as a Bank One or a JPMorgan Chase account."

7. Sign the Dispute under Oath

Signing the dispute letter under oath will convert the dispute into an affidavit, with several resulting benefits. This should provide greater credibility to the consumer's complaint, especially in contrast to the automated, unsworn response of a furnisher. This also advances a claim against the credit bureau that it failed to forward "all relevant information" to the information furnisher. Furnishers may have policies that give greater weight to consumer affidavits and thereby more readily accept the consumer's version of the dispute and resolve it in their favor. But be careful; if there is a questionable statement in the affidavit, the consumer may be challenged later if there is litigation given that statement was sworn to under oath.

8. Include All Documentary Evidence and Suggest Investigative Steps the Credit Bureau Should Take

A consumer's request for investigation should include all documentary evidence and other information that supports the dispute. If the creditor has provided a letter or statement confirming its understanding that the reported information was inaccurate, the letter should be provided with the dispute to the credit bureau.

While it is certainly not a requirement, a consumer may choose to suggest what the credit bureau could do to best accomplish the investigation. In a dispute over ownership of an account, a consumer should request that the credit bureau obtain a copy of the underlying application or contract from the furnisher, and should provide several handwriting samples, such as copies of cancelled checks, a driver's license or backs of credit cards that include her signature.

The credit bureaus may claim that it would be unreasonable to expect them to pay for a handwriting analysis. To avoid this, the consumer could offer to pay this expense. Consumers can also provide the name and contact information of third-party witnesses who support their disputes. For example, if a consumer has been in direct contact with

a furnisher representative who was helpful and agreed with her position, the dispute letter could provide the name and address of that person, and a request that the credit bureau manually send the dispute directly to that person, rather than through an electronic message. If the dispute concerns a public record, a request for investigation could include the name and telephone number of the court clerk. If there was prior litigation involved, the dispute letter could include the name and telephone number of the attorney who previously represented the creditor.

9. Include Information Questioning the Furnisher's Accuracy in Other Contexts

A dispute letter should also include any available information questioning the accuracy of the furnisher's information in other contexts, in order to rebut any claim that the furnisher's reporting could be considered presumptively accurate. There are no limitations as to the nature of such additional information: copies of relevant court opinions against the furnisher in credit reporting contexts, or similar complaints by other consumers against that furnisher. A consumer could even include press clippings that referenced a particular furnisher.

10. Hire a Lawyer

If the consumer has been unable obtain a satisfactory result after sending multiple disputes to the bureaus, he or she may have to think about hiring a lawyer. It is best to hire a lawyer experienced in handling FCRA cases on behalf of consumers. The FCRA is a complicated statute full of pitfalls for inexperienced practitioners. For example, some of the requirements of the FCRA do not permit the consumer to seek redress in court for their violation. A common rookie mistake is to sue under one of these provisions. Listings of consumer lawyers handling FCRA cases can be found at the following websites:

National Association of Consumer Advocates: www.naca.net
My Fair Credit: www.myfaircredit.com

B. RESOURCES

1. Books

The following publications include additional information about the FCRA dispute process, other important rights under the FCRA, and FCRA litigation.

National Consumer Law Center, *Fair Credit Reporting Act* (6th ed. 2006 and Supp.)

Evan Hendricks, *Credit Scores & Credit Reports: How the System Really Works, What You Can Do* (Privacy Times 2007)

Mari Frank, *From Victim to Victor: A Step By Step Guide for Ending the Nightmare of Identity Theft* (Porpoise Press, Inc. 2005)

2. Useful Websites

Resources

My Fair Credit: www.myfaircredit.com

Privacy Times: www.privacytimes.com

FTC Identity Theft site: www.consumer.gov/idtheft

Identity Theft Resource Center: www.idtheftcenter.org

Identity Theft Prevention and Survival: www.identitytheft.org

Consumer Advocacy Organizations

National Consumer Law Center: www.consumerlaw.org

National Association of Consumer Advocates: www.naca.net

Consumers Union: www.consumersunion.org

Consumer Federation of America: www.consumerfed.org

U.S. Public Interest Research Group: www.uspirg.org

Electronic Privacy Information Center: www.epic.org

Privacy Rights Clearinghouse: www.privacyrights.org

Americans for Fairness in Lending: www.affil.org (check out their “How to File a Complaint” page).

Government Websites

Federal Trade Commission: www.ftc.gov

State Attorneys General: www.naag.org/ag/full_ag_table.php

Credit Bureau and Other Industry Sites

Free Annual Credit Report Centralized Source: www.annualcreditreport.com

Equifax: www.equifax.com

Experian: www.experian.com

TransUnion: www.transunion.com

Fair Isaac: www.myfico.com (consumer site)

www.fairisaac.com

Choicepoint: www.choicetrust.com (consumer site)

www.choicepoint.com

Consumer Data Industry Association (CDIA) www.cdiaonline.com

C. REFORM RECOMMENDATIONS

1. The Regulators Must Act

As discussed throughout this report, many of the problems and deficiencies in the FCRA dispute and investigation process may already violate the current law. In fact, many of the consumer cases described in this report resulted in successful lawsuits or legal settlements under the FCRA. Yet the credit bureaus have not fundamentally reformed their dispute and investigation procedures, preferring to fight individual consumers in court, and paying the occasional judgment against them.

In addition, some of the provisions of the FCRA cannot be enforced by consumers harmed by their violation, including the all-important accuracy requirements for furnishers. That requirement can only be enforced by federal regulators, including the FTC and banking regulators.

Despite the problems illustrated in this report, which have been documented in congressional testimony and letters to regulators, the FTC has only brought a handful of cases during this decade against the Big Three credit bureaus. More importantly, none of these cases involved the accuracy of information or their failure to conduct meaningful investigations.

The banking regulators are even worse. We do not know of any FCRA enforcement actions that federal banking regulators have taken against banks. If there have been any such actions, they have not been publicized. The banking regulators are the sole entities capable of enforcing the accuracy requirements of the FCRA against bank furnishers, which include almost all of the major credit card lenders. They have abdicated this responsibility, leaving consumers unprotected against inaccurate and even deliberate misreporting by banks.

The FTC and bank regulators must act to:

- Take regulatory and enforcement action against the credit bureaus' blatant noncompliance with the FCRA dispute and investigation requirements. This includes:
 - Requiring the credit bureau to meaningfully review and evaluate both the consumer's dispute (including supporting documentation) and any the response from the furnisher, rather than merely parroting it.
 - Requiring credit bureaus to send to the furnisher all documents submitted by the consumer in an FCRA dispute pursuant to the FCRA's requirement that "all relevant information" be forwarded.
 - Developing an appeal procedure that the consumer can invoke, including a telephone conference with a bureau employee who has the consumer's dispute and all the documentation provided by the furnisher and the consumer.

- Require credit bureaus to improve their reporting systems by:
 - Promulgating technical specifications for the standardized reporting format (called Metro 2) that allow credit bureaus to track transferred accounts, prevent duplicate accounts, and prevent reinsertion by furnishers of deleted incorrect items.
 - Require the credit bureaus to use the full identifying information of consumers when matching information to a file, including all nine digits of the consumer's Social Security number.

- Taking regulatory and enforcement actions against furnishers for their failure to conduct proper investigations, and require them to make a substantive determination of the validity of the specific dispute at issue. This includes:
 - Requiring furnishers to investigate the specific dispute raised by the consumer rather than merely verifying that the disputed information itself appears in their own records. The furnisher's investigation must involve reviewing the actual documents provided by the consumer, and reviewing documents in its own possession or in the possession of an earlier holder of the debt. It may include requiring furnishers to contact third parties.
 - Requiring furnishers to rebut the consumer's specific dispute by providing to the consumer and the credit bureau documentation that shows that the information furnished is correct. Furnishers should not be allowed simply to tell the credit bureau that the consumer is wrong and the original information was correct. Instead, the furnisher should be required to give the consumer and the credit bureau the underlying information - copies of documents with original signatures to rebut a forgery claim, for example, or copies of the payment record to demonstrate that the claimed balance is correct.
 - Taking action against debt collectors who re-age information so that it stays on consumers' credit reports past the statutorily permitted seven years.

- Require furnishers to improve the accuracy of their reporting by:
 - Requiring furnishers to retain specific operative records for any account for which they are reporting to a credit bureau. For example, credit card furnishers should be required to retain original account applications, original contract or agreements, any billing statements, and any records of disputes.
 - Requiring debt collectors and debt buyer to obtain the original records needed to verify a debt from the creditor and to review them before furnishing information to a CRA. For example, in a credit card case, the debt buyer must be required to obtain and review the consumer's account application, original agreement, history of periodic statements, and any record showing whether any of the debt was disputed with the creditor. If the consumer disputes the debt and the debt buyer does not have adequate original documentation, the account must be deleted from the consumer's file.

2. Congressional Action

The number one right that consumers lack under the FCRA is the ability to ask a judge to tell credit bureaus and furnishers: “fix that report.” With one minor exception, the FCRA only allows injured consumers to get money for damages that they suffered, and a penalty if the violation was willful. The vast majority of courts have held that courts do not have the power to issue an injunction under the FCRA, *i.e.* to order the credit bureaus to do or not do something. The FCRA is an anomaly in this respect, as a Supreme Court decision provides the basis for injunctive relief for most other laws.⁸⁴

Consider a consumer who has filed dispute after dispute with the credit bureaus, who has supplied evidence of fraud or mistake, and who has sued to protect her rights under the FCRA. If she can show that the credit bureaus or furnishers were unreasonable in their investigations, she might be able to get actual damages if she can prove the error caused a denial of credit after the dispute or is in a jurisdiction that permits intangible damages. If she can show the credit bureaus or furnishers knew they were violating the law or acted with reckless disregard, she can seek statutory or punitive damages. But she cannot seek the one thing she really wants, the remedy that started her down this arduous path in the first place - an order telling the credit bureaus and furnisher to correct the error. Providing courts with explicit authority to issue injunctive relief would further the purpose of the FCRA to “assure maximum possible accuracy.”

Congress must also act to fix the broken credit reporting and dispute system, especially if the regulators do not act. If the regulators do not act, Congress should amend the FCRA to statutorily impose the essential requirements discussed in Part V.C.1 above on credit bureaus and furnishers.

⁸⁴ *Califano v. Yamasaki*, 442 U.S. 682 (1979) (“Absent the clearest command to the contrary from Congress, federal courts retain their equitable power to issue injunctions in suits over which they have jurisdiction.”).

Credit Scores & Credit Reports

How The System Really Works
What You Can Do

Evan Hendricks

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Chapter 9

Reinvestigations (or not)

Investigate – v. To observe or study by close examination and systematic inquiry. Systematic—adj. Marked by thoroughness and regularity.

-- Webster's New Collegiate Dictionary

For the past several years, a tension has been building over the adequacy of reinvestigations being performed both by consumer reporting agencies (CRAs) and credit grantors in response to consumer disputes.

During the 2003 Congressional debate over the FCRA Amendments, privacy experts and consumer advocates repeatedly criticized both CRAs and credit grantors for failing to live up to their duties to reinvestigate. Rather than truly investigate, critics charged, CRAs and credit grantors, upon receiving a dispute, prefer only to *compare* the disputed information to what they previously reported. If the disputed information essentially matched what the credit grantor found in its files, then it would “verify” it.

This process has caused many a maddening moment for consumers who dispute what they know to be inaccurate information, but are told by the CRA the information has been “verified.” It also has drawn the attention of the law’s overseers, the FTC and State Attorneys General (AGs), and

its creator, Congress. Between 1991-92, either the FTC or State AGs reached agreements with each of the three major CRAs that included requirements to improve reinvestigations. In 1996, Congress likewise amended the FCRA to put a greater duty on CRAs and on credit grantors to conduct reasonable reinvestigations, and to strengthen consumers' rights if they failed to do so. (See Chapter 10)

Despite these new requirements, the 2003 Congressional hearings confirmed that the CRAs and credit grantors continued to run an automated system of data-comparison which did not comport with the normal definition of "reinvestigate." Many critics argued that CRAs and credit grantors were not complying with the law. A few courts have agreed in individual cases.

In the 2003 Amendments (FACT Act) to the FCRA, Congress again sought to bolster consumers' rights to accuracy. It gave consumers the right to dispute errors directly to the credit grantor when they were the source of the error. (However, consumers should still file disputes with the CRAs to maximize legal options). Congress also enhanced the accuracy standards for credit grantors, requiring that they not report inaccurate data that they "*know or reasonably should know*" as opposed to the old, weaker standard, of "knows or *consciously avoids* knowing." Congress directed the federal banking regulatory agencies to publish rules and guidance to improve furnisher accuracy by December 1, 2004. (They missed the deadline.) The FTC must conduct its own multi-year study on accuracy.

It will take some time to determine what impact these changes will have, and whether they will prompt CRAs and credit grantors to conduct true reinvestigations upon receiving disputes.

To understand how far they have to go, it is necessary to examine the systems that have been in place in the years leading up to the 2003 Amendments. Let's begin by looking at the situation from what might be the perspectives of CRAs.

Rising Volume

For starters, the volume of disputes has risen dramatically. Various depositions of CRA representatives have produced estimates that CRAs can receive 5,000 to 25,000 consumer disputes per day, with 7,000-10,000 being the more typical range. The CRAs staff their dispute departments at levels where dispute handlers are expected to handle between 10-12 consumer disputes per hour. Because each consumer dispute averages three disputed items, this means that the CRA employee only has a few minutes to handle each disputed item. (Do the math: 12 consumer disputes with three items on each dispute, or $12 \times 3 = 36$ disputed items; divide the 36 disputed items by 60 minutes = 1.66 minutes to handle each dispute item.)

This volume naturally poses tremendous challenges for CRAs and credit grantors. An important factor is that CRAs can lower their costs to the extent they can reduce the amount they pay employees. Thus, they strive to automate and minimize the need for human involvement. Possibly the greatest risk to handling disputes too cheaply, and not adequately, is that the CRA or credit grantor could get hit with a large fine or jury award for non-compliance with the FCRA. But since such fines or jury awards have been few and far between, the risk, from the CRAs' and credit grantors' viewpoints, probably does not seem that great.

Credit Repair Volume

Another factor is that a significant percentage of disputes come from credit repair agencies, some of which attempt to get accurate-but-negative information removed from consumers' credit reports by flooding the system with disputes. There have been no independent studies that provide reliable numbers about credit repair volume. In his 2003 testimony before Congress, TransUnion CEO Harry Gambill estimated that 35 percent of disputes came from credit repair

agencies. A second industry source placed it closer to 25 percent. Even if that range is accurate, it means that about 65-75 percent of disputes are from individual consumers and are presumably legitimate. It is difficult to believe that CRAs and credit grantors can adequately investigate thousands of legitimate disputes a day using the current system.

To handle the volume, the CRAs created “E-OSCAR,” an automated system for exchanging messages when consumers dispute inaccuracies. Remarkably, the CRAs found a way to profit from disputes as well. For example, Equifax pays its outsource vendor in the Philippines between \$.41 and \$.57 to process each consumer dispute letter. But Equifax charges creditors at least \$.25 for each account dispute (ACDV) processed through E-OSCAR. Thus, for a letter disputing five accounts, Equifax would charge creditors at least \$1.25, but would only have to pay its vendor about \$.57. Accordingly, in 2005 E-OSCAR was transferred from its creator, the Consumer Data Industry Assoc. (CDIA), a non-profit industry lobbying group, to a new for-profit company, Online Data Exchange, L.L.C.¹

The CRAs naturally have reduced costs by outsourcing dispute handling to call centers in low-wage countries like the Philippines, India, Jamaica and Costa Rica.²

Exchanging Codes

As we saw in Chapter 5, “How To Dispute Errors,” the dispute form urges consumers to categorize their dispute, e.g., “Not Mine,” or “Paid In Full.” The CRAs typically have a two-digit code for each category.³

¹ Prepared statement of Leonard Bennett, “Fair Credit Reporting Act: How it Functions for Consumers and the Economy,” before the House Committee on Financial Services, June 19, 2007;

www.house.gov/apps/list/hearing/financialsvcs_dem/ht061907.shtml

² *Privacy Times*, Sept. 12, 2003 Volume 23 No. 17; also see Lazarus, David, “Credit Agencies Sending Our Files Abroad,” *San Francisco Chronicle*, Nov. 7, 2003.

³ Or, a two-symbol, alpha-numeric code, i.e., “A4” means “not mine”

When a consumer writes to the CRA to dispute inaccurate information in his or her credit report, the CRA typically reduces the consumer's dispute to the corresponding two-digit code and transmits it to the creditor in the form of an Automated Consumer Dispute Verification (ACDV). The creditor typically only checks to see if the data it has on file is roughly the same as that which it furnished previously, or if two of the consumer's identifiers in its file match those on the ACDV. If they do, then the creditor "verifies" the disputed data.

It's conceivable that this system might be an appropriate and effective response to the tactics of credit repair agencies. Some credit repair specialists advertise that they can "remove" negative information from consumers' credit reports (even if that negative information is accurate). They typically try to flood the system with disputes in the hope that CRAs and credit grantors won't meet the 30-day deadline reinvestigation deadline, thereby forcing them to delete negative data that they didn't have time to verify.

But again, it is difficult to believe that CRAs and credit grantors can adequately investigate thousands of legitimate disputes a day using the current system. According to the CRAs' trade group CDIA, 46% of disputes were verified as reported; 27% were modified or updated per furnisher's instructions; 10.5% had data deleted per furnisher's instructions; 16% had data deleted due to legal time limits.⁴

Not True, But 'Verified'

This process is particularly frustrating for consumers who are victims of mixed files and/or identity theft. For instance, Judy Thomas, a Klamath Falls, Oregon realtor in 1996 first disputed information in her credit report that actually related to the credit problems of Judith Upton, of

⁴ Statement of Richard J. Hillman Director, Financial Markets, General Accounting Office, Before the Senate Committee on Banking, Housing, and Urban Affairs, July 31, 2003 www.gao.gov/new.items/d031036t.pdf

Stevenson, Washington. TransUnion said it would be removed. But in 1999, Ms. Thomas discovered the information had been reinserted, so she disputed it again. This time, the furnishers “verified” because the information disputed by Thomas was precisely the same information about Ms. Upton that the credit grantors had furnished before. In other words, their automated comparison about “then-and-now” showed no discrepancy, so neither the credit grantor nor TransUnion saw any reason to change it.

Carol Fleischer was a Michigan resident who sued after TransUnion failed to unmix her file, which included a negative Capital One account that was not hers.

Regina Sorenson, a TransUnion consumer affairs manager, testified that this two-dimensional exchange of messages between itself and Capital One was the extent of TU’s “investigation.” Here’s how she described it when questioned by Fleischer’s co-counsel, David Szwak:

Szwak - Now you sent [Capital One] a CDV (consumer dispute verification) and the response came back verified as to the name and the Social Security number; is that true?

Sorenson - Verified means the account information was accurately reported and they also verified name and Social Security number.

Szwak - And as a result, you all completed your investigation by updating it to show it had been verified by Capital One and leaving Capital One on Ms. Fleischer’s credit report; is that true?

Sorenson - Yes, it is.

Szwak - Other than sending the CDV to the six furnishers, what else did Trans Union do to investigate Ms. Fleischer’s complaints?

Sorenson - **Nothing else.**⁵

⁵ Deposition of Regina Sorenson, in Carol Fleischer v. TransUnion, et al. U.S. District Court for the Eastern District of Michigan (Southern Div); Case No. CV 02-71301.

As an 18-year-old, Jason Turner, of Alabama, did not think Equifax had a file on him. But when he applied for his first Capital One card, Equifax returned a credit report showing he had several delinquent accounts, one of which went bad supposedly when Jason was 14 years old. Naturally, he was rejected for the credit card. He was also rejected for an auto loan.

Young Jason eventually learned that every time he applied for credit, Equifax would create a report that included the bad history of a much older Jason Turner. This happened because the names were identical, and because 7-out-of-the-9 digits of their SSNs were identical. (The older Jason never lived in Alabama.) The Equifax algorithm assumed the two Jasons were the same person, and disregarded major discrepancies in ages, as well as dates of birth and addresses.

Both Jason and his mother tried to convince Equifax that the derogatory accounts did not belong to young Jason. But they ran into a wall. First, the Equifax dispute handlers apparently did not know that the partial match of the two Jason Turners' SSNs kept causing the older Jason's bad payment history to be dumped onto young Jason's report when he applied for credit.

In response to the dispute, Equifax's Celestina Spencer queried the system using young Jason's SSN. But this query used a "search logic" requiring an exact match of all nine digits of the SSN. Ironically, Spencer was unable to find any accounts that belonged to young Jason: by using the stricter, 9-for-9 digit SSN match, Spencer ensured that the older Jason Turner's derogatory information was not mixed into Young Jason's credit report. Thus, Spencer told Jason's mother that Jason "did not have a file."⁶

⁶ Deposition of Celestina Spencer, Jason Turner v. Equifax Credit Information Services, Inc.; U.S. District Court for the Northern District of Alabama (Southern Div); Case No. CV 02-J-0787-S.

Mrs. Turner tried to explain that Equifax disclosed an inaccurate file to Capital One and to the auto dealer, and that it needed to be corrected. But as Ms. Spencer later said in a deposition, “Nothing was being done because there was nothing to do I wanted her [Mrs. Turner] to understand that it was not his credit file for me to do anything to.”

In other words, Equifax was telling Capital One that Jason was a deadbeat, but telling his mother that it “did not have a file” on him. When confronted with this discrepancy, Ms. Spencer, the Equifax dispute handler, said:

There should not have been a file, but there could have been because his addresses are here [and] because they would have keyed in his name and his addresses. Our system -- I don't know how to answer that question. He is there, but he is not there.

After months of trying, Jason's mother finally convinced Ms. Spencer to conduct a reinvestigation. So what did she do? Ms. Spencer sent a standard “CDV,” or Consumer Dispute Verification, to Capital One. But the CDV listed the older Jason Turner's SSN, date-of-birth, and derogatory trade lines, with the younger Jason's address. Capital One then “verified” the information.

An exchange between Christopher Kittell, a Mississippi attorney who represented young Jason Turner, and Alicia Fluellen, senior manager for Equifax's Office of Consumer Affairs, confirmed that the CDV exchange *was* the Equifax investigation

Kittell: Are there are other methods of investigation despite the CDV or other than the CDV?

Fluellen: No, we send out a CDV.

Kittell: That's it. If it comes back one way, good for the consumer, if it comes back agreeing with the

creditor, then not agreeing with the consumer, then it stays?

Fluellen: Correct.

Kittell: Basically, Equifax takes the word of the creditor, whatever the creditor says is what Equifax does?

Fluellen: Yeah.⁷

Of course, many felt this was a huge breakdown in how the system was supposed to work. In the 1996 Amendments, Congress increased duties on CRAs to ensure they would investigate disputes. The amendments required that CRAs forward disputes to creditors within five days, and then complete the reinvestigation within 30 days. If not completed by the 30-day deadline, the law required that the disputed data be deleted. In an effort to add depth to reinvestigations, the Amendments required CRAs to “provide all relevant information” concerning a consumer’s dispute to the furnishers. That meant that if a consumer attached payment statements or letters to his dispute, the CRA was supposed to send them to, or otherwise advise the creditor. Moreover, for the first time, the Amendments placed a duty on creditors to reinvestigate, but generally imposed liability for failing to do so after they received consumer disputes from the CRA.

Despite these changes in the law, there was abundant evidence that the old ways continued right up to the point that this book went to press.⁸ Many believed this two-dimensional message exchange does not amount to a true reinvestigation. (*Webster’s New Collegiate Dictionary* defines “investigate” as “to observe or study by close examination and systematic inquiry.” One of the definitions of “systematic” is “marked by thoroughness and regularity.”)

⁷ Deposition of Alicia Fluellen, Jason Turner v. Equifax Credit Info. Serv., Inc.: U.S. Dist. Ct., Northern Dist. of Alabama; Case No. CV 02-J-0787-S. Equifax designated Fluellen as its “30(b)(6)” witness, meaning she was representing the company and describing its policies.

⁸ September 2007

Credit Grantors

As noted earlier, major credit card companies have seen their dispute volume rise in recent years. They too generally try to cope with the volume by using an automated message exchange.

Pamela Tuskey, a manager in Capital One's credit report dispute department, confirmed in a deposition with Ian Lyngklip, a Michigan attorney, that in October 2001, Capital One received about 1,000 disputes per day. By May 2002, it had grown to 2,000 disputes per day. By the spring of 2003, the official said the number of disputes had grown to 4,000 per day. Some of the increased volume was attributed to the boom in home buying and mortgage refinancing, when more and more consumers discovered the importance of their credit scores, she said.⁹

Tuskey said her department's job was to "verify" disputed information that Capital One had reported to the CRAs. That meant her personnel would simply check the disputed information against the information in its system. If the two matched up, it was "verified."¹⁰

She said her department did not have ready access to original credit card applications or other primary documents that might come in handy for affirming that the consumer's dispute was well-founded. The pulling of paper files was considered "in-depth research," and was not handled by her department. Instead, "research" was conducted by a smaller committee in charge of "escalated" disputes. One example of an "escalated" dispute was an irate customer, or attorney, who directly wrote or called Capital One, she said.¹¹

When Lyngklip asked Tuskey why her department did not do "in-depth research," she replied that sometime

⁹ Deposition of Pamela Tuskey, in Carol Fleischer v. Trans Union, et al., U.S. District Court for the Eastern District of Michigan (Southern Div); Case No. CV 02-71301.

¹⁰ *Id.*

¹¹ *Id.*

around February of 2000, representatives from Trans Union, Experian and Equifax each paid separate visits “to explain to my team how to more properly and more accurately work accounts.”¹²

“One of the questions that I had for them, as a manager,” Tuskey continued, “was should we verify the accounts – and I even explained to them what my definition of verify is – which is, we pull up our system of record, in this case Unisys or Beast, we look at what the bureau has sent us on the ACDV. If there are any discrepancies, we make sure that what the bureau has mirrors exactly what we, as Capital One, have. That’s verifying,” Tuskey said.¹³

Lyngklip: That was what you described to the representatives as verifying?

Tuskey: Yes.

Lyngklip: And what did they say in response to that?

Tuskey: Well, I actually followed that up with, ‘Do you want us to do that, or do you want us to do things such as pull statements, etc., actually do the research which would involve CHIA?’¹⁴ And in each case, the bureau rep said, ‘No, we want you to verify it. We want you to make our system look like your system.’ So that’s what we’ve been doing.

However, in a mixed file or identity theft case, having the credit bureau’s data “mirror” Capital One’s data was not going to establish whether the information was accurate in the first place.

One thing that was missing from this equation was concern for the truth. After all, shouldn’t the purpose of an “investigation” be to get to the truth? In fact, both CRA officials and credit grantor personnel have testified that it’s

¹² *Id.*

¹³ *Id.*

¹⁴ CHIA is the system where Capital One stores applications and other primary documents

not their job to arbitrate the truth. Look at this exchange between Lyngklip and Tuskey:

Lyngklip: For purposes of how you administer the FCRA, does the underlying truth of the matter enter into the decision? In other words, if the information in Cap One's system is not, in fact, true, is Cap One going to verify the data as accurate as long as it matches?

Tuskey: Not – if we – if we do not – I'm not quite sure if you're – are you – restate that question.

Lyngklip: Sure, I can do that. Cap One, as a matter of how it administers to the FCRA . . . and looks at the accuracy requirements, does not equate accuracy with truthfulness, what it does is it measures accuracy in terms of whether or not the data matches between what's in the credit reporting system and what's in Cap One's computer; is that a fair statement? . . .

Tuskey: So your, your – the way the question is posed to me makes it sound like I have to choose between whether I'm saying what my associates do is accurate or truthful but not both.

Lyngklip: Well, no, what I'm asking is this: Is it possible, is it possible that Cap One will verify information that is not, in fact, truthful?

Tuskey: There's a possibility of that. It certainly would not be done intentionally.¹⁵

Is That All There Is?

Lyngklip asked if Tuskey's department ever did anything but check its own computers. "What about picking up the phone and calling up the person who is disputing the credit report?" Lyngklip asked. "It would seem to me that

¹⁵ Deposition of Tuskey, *op. cit.*

that would be a pretty good source of information to determine whether or not two individuals are the same person.”

“No, my team does not have any direct contact with the cardholders,” Tuskey replied. “Again, we’re not a customer-contact center. That’s not within the scope of our job.”

Training also did not appear to be a priority.

Lyngklip: How did you find out about the procedures and in terms of how they come to their decision, and how did you find out about the mechanics of the credit dispute process?

Tuskey: I found out the way any new associate would find out. I had side-by-side training. At the time that we’re looking into here, we had no formal policies or procedures, no written documentation. It was really all on-the-job training, so I became familiar by sitting with a veteran associate as well as a quality associate just like everybody else. . . .

Lyngklip: This might sound like a silly question, and I don’t mean to be flip at all, but who trained the first staff person? Do we know how those procedures were handed down and where they came from originally?

Tuskey: No. My guess, since everything had not been documented at all, my guess is it was just like oral history; you tell me and I’ll tell the next person and the next person, and a lot of judgment calls going on.

Lyngklip: Now, that describes how the decision-making process is made in terms of whether or not a particular dispute will be resolved in favor of or against a consumer, what about the mechanics of navigating the screens? Is that something that’s written down in training manuals or guides?

Tuskey: Now it is.

Lyngklip: Again, when was that implemented?

Tuskey: Three weeks ago.

Tuskey's deposition was taken May 21, 2003, some six years after the FCRA Amendments of 1996 put a duty on Capital One and other creditors to report information accurately, and to investigate consumer disputes. A company source said that in light of the 2003 Amendments to the FCRA, Capital One was reviewing its credit reporting-related procedures.

MBNA

At MBNA, an "investigation" similarly consists of a *comparison* of the disputed data with information in its database, the Customer Information System (CIS). One of the first to delve into its practices was Leonard Bennett, a Newport News, Virginia attorney who represented Linda Johnson.

The lawsuit swirled around an MBNA MasterCard opened by plaintiff Linda Johnson's ex-husband, Edward Slater, in 1987 – four years before he married her. They had since divorced. Johnson said she was only an authorized user, which meant she was not responsible for paying the account. In December 2000, Slater filed for bankruptcy, and MBNA promptly removed his name from the account. That same month, MBNA contacted Johnson and informed her that she was responsible for the approximately \$17,000 balance on the account. After obtaining copies of her credit report from Experian, Equifax, and Trans Union, Johnson disputed the MBNA account with each of them. Experian and Trans Union sent automated consumer dispute verifications (ACDVs) to MBNA specifically indicating Johnson's claim that she was not a co-obligor on the account.

MBNA agents responded by comparing the disputed data with the account information contained in MBNA's computerized Customer Information System (CIS). Since the two were identical, MBNA "verified" that the disputed information was correct. In other words, MBNA did nothing more than confirm that it indeed reported the original (inac-

curate) data. The CRAs continued to report it on Johnson's credit report.

Tricia Furr, an MBNA credit reporting specialist, confirmed that MBNA's "Desktop Procedure" manual directs specialists to confirm a match of two out of three identifiers – name, address and/or SSN. Once a two-out-of-three match is established, MBNA can inform the CRA that the disputed information is "verified as reported." Ms. Furr said that MBNA's "reinvestigations" did not go beyond the information contained in its own CIS.¹⁶

Furr: I looked at the balance that we have on CIS and the history of the account as compared to the trade line as opposed to what we had on our Customer Information screen. . .

Bennett: In performing the investigation and re-investigation of consumer disputes, once it receives an ACDV¹⁷ from a credit reporting agency, when are MBNA's credit reporting specialists supposed to look beyond the Customer Information System for investigation? . . . I am asking the practices and procedures now.

Furr: The Customer Information System is the only thing that we have to use for verification. So, there is no where else to look.

Bennett: Do you ever pull documents, like old statements, and check payments and credit card applications?

Furr: No, sir.

¹⁶ The depositions of MBNA personnel were taken in the case, Linda Johnson v. MBNA America Bank, N.A., Slip Op. No. 3:02 cv 523, U.S. District Court For The Eastern District of Virginia (Richmond Division).

¹⁷ The dispute form is known as an "ACDV," or Automated Consumer Dispute Verification

Reading from MBNA's internal records, MBNA Vice President Edward Hughes quoted an MBNA employee's communication to a customer's attorney: "It would be up to (c)ard holder to prove MBNA was reporting wrong, not MBNA proving right."

Here Comes The Judge

In this case, Hughes' statement proved to be wrong. Linda Johnson was one of the few consumers who sued and actually had the chance to tell her story to a jury. MBNA argued that its verification methods complied with the FCRA. The jury disagreed, and awarded Johnson \$90,300.

Judge Richard Williams affirmed the jury verdict. "According to [MBNA], the duty to investigate means that any investigation is sufficient, no matter how cursory. Such a construction is illogical. There would be no point in having the statute, and the requirement of an investigation, if there was no qualitative component to the investigation. The statute itself does impose a qualitative component to the [MBNA's] negligence," Judge Williams said.¹⁸

MBNA appealed Judge Williams' decision. But on February 11, 2004, a three-member panel of the U.S. Court of Appeals for the Fourth Circuit affirmed, finding that MBNA's standard response to consumer disputes did not amount to a true "reinvestigation" under the FCRA.

"MBNA argues that the language of § 1681s-2(b)(1)(A), requiring furnishers of credit information to 'conduct an investigation' regarding disputed information, imposes only a minimal duty on creditors to briefly review their records to determine whether the disputed information is correct," the panel wrote, in an opinion authored by Chief Judge William W. Wilkens. "Stated differently, MBNA contends that this provision does not contain any qualitative

¹⁸ Johnson v. MBNA, op. cit., bench ruling February 24, 2003

component that would allow courts or juries to assess whether the creditor's investigation was reasonable.”¹⁹

“The key term at issue here, ‘investigation,’ is defined [by the dictionary] as ‘a detailed inquiry or systematic examination.’ Thus, the plain meaning of ‘investigation’ clearly requires some degree of careful inquiry by creditors,” he wrote.

Further, he said, the statute “uses the term ‘investigation’ in the context of articulating a creditor’s duties in the consumer dispute process outlined by the FCRA. It would make little sense to conclude that, in creating a system intended to give consumers a means to dispute – and, ultimately, correct – inaccurate information on their credit reports, Congress used the term ‘investigation’ to include superficial, *unreasonable* inquiries by creditors. We therefore hold that § 1681s-2(b)(1) requires creditors, after receiving notice of a consumer dispute from a credit reporting agency, to conduct a reasonable investigation of their records to determine whether the disputed information can be verified.”

MBNA also tried to argue that its investigation in Johnson’s case was reasonable. But the court pointed to the specific nature of Johnson’s dispute, and the testimony of MBNA agents that their investigation was primarily limited to (1) confirming that the name and address listed on the ACDVs were the same as the name and address contained in the Customer Information System, and (2) noting that the CIS contained a code indicating that Johnson was the sole responsible party on the account.

“The MBNA agents also testified that, in investigating consumer disputes generally, they do not look beyond the information contained in the CIS and never consult underlying documents such as account applications. Based on this evidence, a jury could reasonably conclude that

¹⁹ Johnson v. MBNA America Bank: 357 F.3d 426 (4th Cir. 2004).

MBNA acted unreasonably in failing to verify the accuracy of the information contained in the CIS,” he wrote.

Richard Rubin, a Santa Fe, New Mexico attorney who argued the case for Johnson before the Fourth Circuit, noted that the panel adopted his position that had MBNA simply told the truth and stated that its investigation was inconclusive, the CRAs would have deleted the tradeline as required by the FCRA, and the litigation never would have occurred.

About The Author

Since 1981, Evan Hendricks has been Editor/Publisher and founder of Privacy Times, a newsletter based in the Washington, D.C. area. Through the newsletter alone, he has published nearly 3,000 pages covering a wide range of privacy and information law subjects, including the Fair Credit Reporting Act.

Mr. Hendricks regularly testifies before Congress, with four appearances in 2003.²⁰ He is a regular presenter at Federal Trade Commission workshops.²¹ He has been qualified by the courts as an expert witness in FCRA and identity theft cases. Mr. Hendricks has served as a consultant on privacy issues to federal and state governmental organizations, and businesses. He has been a featured American presenter at events in Paris, France, Venice, Italy, Cardiff Wales, London, England and Ottawa, Ontario. He is regularly quoted in the mainstream media and trade press.

Mr. Hendricks has a Bachelor of Arts from Columbia College, Columbia University. He attended there after transferring from University of Oregon.²²

²⁰ http://banking.senate.gov/03_07hrg/071003/index.htm
<http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=229>
<http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=202>
http://judiciary.senate.gov/testimony.cfm?id=983&wit_id=2790

²¹ <http://www.ftc.gov/bcp/workshops/infoflows/030618agenda.html>

²² Go Ducks!

Recent Testimony Before Congress & The FTC by Evan Hendricks

“What Borrowers Need to Know About Credit Scoring Models and Credit Scores,” House Financial Services Subcommittee on Oversight, July 29, 2008.[1]

“Credit Reports: Consumers’ Ability to Dispute and Change Information,” House Financial Services Committee, June 19, 2007.[2]

“Privacy in the Commercial World II,” House Energy & Commerce Subcommittee On Commerce, Trade, and Consumer Protection, June 20, 2006[3]

“Financial Data Protection Act of 2005,” House Financial Services Subcommittee on Financial Institutions and Consumer Credit, November 9, 2005[4]

“Credit Card Data Processing: How Secure Is It?” House Financial Services Subcommittee on Oversight and Investigations, July 21, 2005[5]

“Identity Theft: Recent Developments Involving the Security of Sensitive Consumer Information,”[6] Senate Banking Committee, March 15, 2005

“The Accuracy of Credit Report Information and the Fair Credit Reporting Act;” Senate Banking Committee, July 10, 2003[7]

“The Role of FCRA in the Credit Granting Process,” House Financial Services Subcommittee on Financial Institutions & Consumer Credit, June 12, 2003[8]

"Database Security: Finding Out When Your Information Has Been Compromised," Senate Judiciary Subcommittee on Technology, Terrorism and Government Information, Nov. 4, 2003[9]

“Fighting Fraud: Improving Information Security,” House Financial Services Subcommittee on Financial Institutions & Consumer Credit, and Oversight, April 3, 2003[10]

“Information Flows: The Costs and Benefits to Consumers and Businesses of The Collection and Use of Consumer Information,” Federal Trade Commission, National Workshop, June 18, 2003

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- [1] http://www.house.gov/apps/list/hearing/financialsvcs_dem/hr072908.shtml
 - [2] www.house.gov/apps/list/hearing/financialsvcs_dem/ht061907.shtml
 - [3] <http://energycommerce.house.gov/108/Hearings/06202006hearing1938/Hendricks.pdf>
 - [4] <http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=425>
 - [5] <http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=407>
 - [6] <http://banking.senate.gov/index.cfm?Fuseaction=Hearings.Detail&HearingID=144>
 - [7] http://banking.senate.gov/03_07hrg/071003/index.htm
 - [8] <http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=229>
 - [9] http://judiciary.senate.gov/testimony.cfm?id=983&wit_id=2790
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09/29/08

A Look Behind the Numbers

Foreclosure Filings in Cuyahoga County

Lisa Nelson

Introduction

Northeast Ohio's Cuyahoga County, home to the city of Cleveland, has been called the epicenter of the nation's foreclosure crisis. While effects of the crisis are being felt in regions across the country, Cuyahoga County has consistently been listed at or near the top of areas hit hardest by foreclosure. Why?

In this report, we provide rates of foreclosure in different Cuyahoga County neighborhoods, detail patterns in the geographic distribution, and describe the demographic characteristics of neighborhoods where foreclosure rates are highest. We also describe common features of the loans that ended in foreclosure. Our analysis draws on several data sources, including 2006 and 2007 foreclosure filing data from the Cuyahoga County Common Pleas Court, ^[1] mortgage characteristics from 2005 Home Mortgage Disclosure Act (HMDA) data, and demographic data from the U.S. Census.

This detailed picture provides a useful first step in understanding foreclosure trends in Cuyahoga County and elsewhere. At the conclusion of this report we list a series of hypotheses that the Federal Reserve Bank of Cleveland may test in future research.

Foreclosure patterns in Cuyahoga County

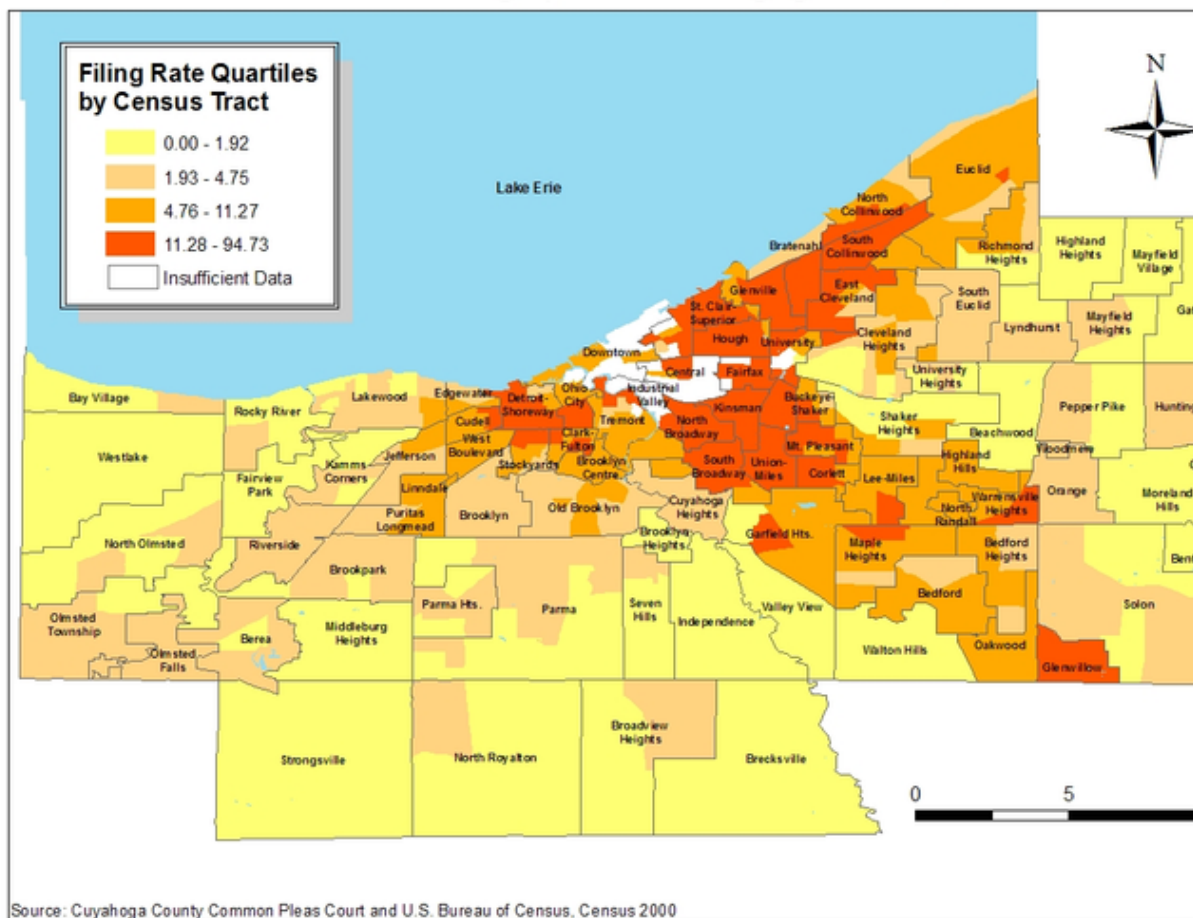
Foreclosures in Cuyahoga County (see Table 1) are concentrated in a small number of low- and moderate-income neighborhoods.^[2] Almost half (48.8 %) of 2007 foreclosures were filed on homes in just 15 of the county's 95 neighborhoods.^[3] Two inner-ring suburbs, Euclid and Maple Heights, had the highest volume of foreclosure filings (634 and 545, respectively), followed by Glenville, a Cleveland neighborhood, at 525.

Although rankings among neighborhoods show slight changes from 2006 to 2007, the top 15 on the list remain unchanged from one year to the next. The suburb of East Cleveland, with the highest number of foreclosure filings in 2006, dropped to number five in 2007. Maple Heights, which had the sixth-highest number of foreclosure filings in 2006, moved up to the second spot in 2007. Euclid topped the list in 2007, moving up from the number-two spot in 2006.

Table 1: Foreclosure filings in 2006 and 2007

	2006		2007	
	Number	Rate	Number	Rate
Cleveland, city	7,326	10.7	7,457	10.7
Suburbs	5,889	2.9	6,324	3.1
Cuyahoga County	13,269	4.9	13,846	5.0

Foreclosure Filings per 100 Mortgaged Units, 2007



As illustrated in Map 1, the highest rates of foreclosure in 2007 are found in contiguous east-side neighborhoods of the city of Cleveland, with one exception: Detroit–Shoreway, on the city’s west side, close to downtown.^[4] Foreclosure rates are highest in the Cleveland neighborhoods of Kinsman (47.2 filings per 100 mortgaged units), Fairfax (29.4 per 100), and North Broadway (24.7 per 100). East Cleveland, the only suburban neighborhood in this group, has a rate of 16 foreclosure filings per 100 mortgaged units. Just as we saw with foreclosure volume, the 15 neighborhoods with the highest rates of foreclosure in 2007 were virtually unchanged from 2006.

Characteristics of high-foreclosure-rate tracts

To learn about the characteristics of the Cuyahoga County neighborhoods in which foreclosures are concentrated, we grouped the data into four equal parts, or quartiles, based on the tract-level foreclosure filing rates across the county. Census tracts with the highest foreclosure rates are in the highest category, and tracts with the lowest foreclosure rates are in the lowest. Table 2 illustrates the differences across the quartiles.

Table 2: Characteristics of Tracts by Foreclosure Filing Rates, 2007

Tract Characteristics	Quartiles			
	Lowest	Second	Third	Highest
Number of census tracts	118	119	119	119

Foreclosure filings (2007)	1,259	2,584	4,253	5,602
Foreclosure filings per 100 mortgaged units	1.3	3.1	7.1	18.8
Range of foreclosure filing rate (min-max)	0-1.92	1.94-4.75	4.76-11.27	11.29-94.73
Percent African-American	3.0	9.8	42.8	73.7
Percent minority*	8.0	16.0	51.3	79.9
Percent high-cost loans (2005)	15.2	24.6	44.0	63.0
Percent subprime lenders (2005)	10.5	17.0	32.2	50.2
Percent owner-occupied	76.5	65.8	60.0	42.6
Median household income	\$56,753	\$42,495	\$33,346	\$21,592

* Includes all except non-Hispanic whites

The foreclosure rate for tracts in the highest quartile (nearly 19 filings per 100 mortgaged units) is almost three times the rate in the third quartile, six times the rate in the second quartile, and nearly 19 times the rate in the lowest quartile. When examining loan characteristics in the HMDA data, we find that 63 percent of the loan originations in the highest-quartile tracts were high-cost loans, compared to about 44 percent in the third and 16 percent in the lowest quartile.^[5] Subprime lenders—defined as those who issue at least half of their loans as subprime—originated 50 percent of the loans in the high-foreclosure tracts, compared to 32 percent in the third quartile and about 11 percent in the lowest quartile.^[6]

We also find some notable differences when looking at the demographic characteristics of these tracts. The median household income in the lowest-foreclosure-rate quartile is about two-and-a-half times higher than the income in the high-foreclosure-rate quartile. Even in the second quartile, the median income is nearly twice the income of the highest-rate quartile. African-Americans make up 74 percent of the population in the high-rate quartile and just 3 percent in the low-rate quartile.^[7] Minorities, which include everyone except non-Hispanic whites, make up 80 percent of the population in the high-foreclosure-rate quartile and just over 8 percent in the tracts in the quartile with the lowest rates of foreclosure. Owner occupancy is less in the quartile with the highest foreclosure-rate tracts (42.6%) than in the lowest-rate tracts (76.5%).

The tracts in the highest quartile of foreclosure rates are home to 40 percent of the foreclosure filings countywide, but contain just 19 percent of the county's population. Half (49.5%) of the county's African-American population lives in the highest-foreclosure-rate quartile, and another 34 percent lives in the next-highest-rate quartile. Not only are foreclosures disproportionately found in neighborhoods that contain a relatively smaller share of the county's population, but these high-foreclosure neighborhoods also have the lowest incomes and the highest shares of African-American residents in the county.

To calculate the statistical validity of the relationships that seem apparent from our observations of the raw data, we correlate the tract-level foreclosure filing rates with selected demographic and loan characteristics. Correlations examine the relationship between two variables and simply tell us whether variables move in the same or a different direction. They cannot tell us anything about causation—particularly in the case of the foreclosure crisis. The variables we are looking at are strongly correlated with each other, making it difficult to calculate the independent effect of each variable. At most, correlations may help us identify some of the factors that might be involved.

We find that foreclosure filing rates are positively and strongly correlated with the following:

the percent of high-cost loans,

- the percent of loans originated by subprime lenders,
- the percent of loans made by nondepository institutions,
- the percent of the population who are unemployed,
- the percent of the population without a high school degree, and
- the percent of the population who are African-American residents.

The positive correlation indicates that as foreclosure rates increase, so do the rates of these other variables. Median household income is negatively and strongly correlated with foreclosure rates, meaning that as income decreases, foreclosure filing rates increase.

Tract characteristics by income level

To further explore the characteristics of the tracts affected most by foreclosures, we examine foreclosure rates and selected characteristics of census tracts that are grouped by income. To do so, we placed the census tracts into four equal groups, or quartiles, based on median household income. Tracts with the highest median incomes are in the highest quartile, and tracts with the lowest median income are in the lowest. As illustrated in Map 2, tracts in the lowest income quartile are heavily concentrated on the east side of the county, particularly in Cleveland's east-side neighborhoods. This map resembles the pattern found in Map 1, where the highest rates of foreclosures are also found on the east side.

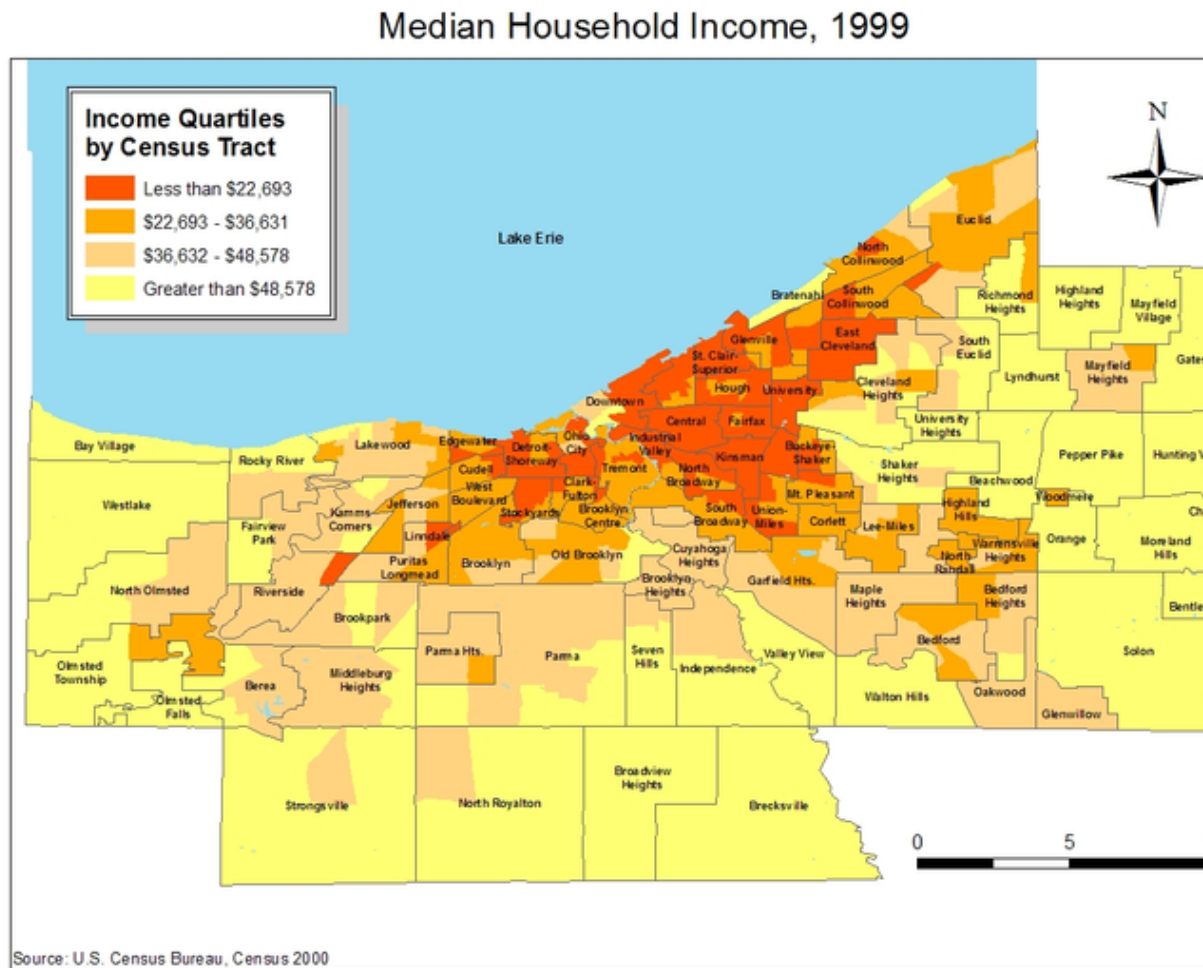


Table 3 shows selected demographic and loan characteristics for the four income quartiles. As we

found when examining foreclosure-rate quartiles, foreclosures are concentrated in low-income areas that also have high percentages of African-Americans. Foreclosure rates are much higher in the lower-income tracts—19 per 100 mortgaged units compared with only two per 100 in the highest-income tracts. African-Americans make up most of the population (71.1%) in the lowest-income tracts but just 6 percent in the highest-income tracts. High-cost loan originations dominate in the lowest-income quartile, making up 60 percent of all originations, compared with just 16 percent in the high-income quartile. This may not be so surprising, given that lower-income borrowers presumably have characteristics that tend to pose a greater credit risk to lenders—for example, blemished credit histories, higher debt, and higher loan-to-value ratios.

Table 3: Characteristics of Tracts by Income Quartile

Tract Characteristics	Quartiles			
	Lowest	Second	Third	Highest
Median household income (min-max)	\$0-\$22,692	\$22,693-\$36,631	\$36,632-\$48,578	\$48,579 or more
Foreclosure filings (2007)	3,562	4,579	3,785	1,855
Foreclosure filings per 100 mortgaged units	19.0	8.7	4.0	1.7
Percent African-American	71.1	42.0	16.4	6.0
Percent high-cost loans (2005)	60.0	45.4	30.6	16.7
Rate above prime for high-cost loans (2005)	4.8	4.8	5.2	5.2
Origination by nondepository institutions (2005)	55.6	44.8	30.9	24.6
Average number of bank branches within a 3-mile radius (2005)	31.4	26.4	26.0	22.1

As a measure of geographic proximity to financial institutions, we included the number of bank branches in this analysis. Table 3 illustrates that the average number of bank branches within a three-mile radius of the geographic center of the tract is greatest in the lowest-income quartile and declines progressively through each of the higher-income quartiles.^[8] Despite their relatively high proximity to lenders, however, a majority of the borrowers in the lowest-income quartile of these Cuyahoga County tracts received loans not from these bank branches, but from nondepository institutions instead.

Table 3 also shows that lower-income borrowers are more likely to obtain a high-cost loan (although high-cost loans were provided to borrowers in each income quartile). The data show that in the top two income quartiles, high-cost loans were distributed across many lenders. Conversely, in the bottom two income quartiles, high-cost loans were provided by a much narrower range of lenders: 34 percent of all high-cost loans in the tracts of the lowest income quartile were originated by a single lender; in the second income quartile, 21 percent of the high-cost loans were originated by this same lender. Meanwhile, in the lowest-income quartile, a total of three lenders originated 50 percent of high-cost loans, while in the second quartile it was six lenders, and in the highest quartile, 14.

Foreclosure trends across income quartiles

When comparing the 2007 foreclosure filing rates in each of the income quartiles to those in 2006, we find increases in the filing rates in all but the lowest-income quartile, where there was a slight decrease in the filing rate. The largest increases occurred in the third and highest-income quartiles, where foreclosure filings grew by 406 and 116, respectively, reflecting rate increases of 11 percent and 6 percent. These numbers tell us that although the greatest numbers of foreclosed homes are still concentrated in the county's lower-income tracts, the growth rate of foreclosure filings in the upper-

income quartile, primarily suburban census tracts, appears to be increasing.

Next steps

The geographic concentration of foreclosures in Cuyahoga County is quite clear. Foreclosures are concentrated mainly in the city of Cleveland's east side neighborhoods, which are home to high percentages of minority and low-income populations. Additional analysis and research might examine a number of issues that this analysis highlighted, including whether the geographic concentration of foreclosures evident in Cuyahoga County is present in other counties throughout our district, which comprises all of Ohio, western Pennsylvania, and parts of Kentucky and West Virginia. If so, what are the characteristics of high-foreclosure-rate tracts in these counties? How do these characteristics vary across geographies? What characteristics or factors will help us to better understand the high rates of foreclosure in Cuyahoga County? Too, the geographic concentration of foreclosures undoubtedly leads to negative spillover effects—in particular, increased numbers of vacant and abandoned properties. How can or how will these communities effectively respond to the foreclosure crisis, coupled with an impending additional influx of vacant properties, given the weakened state of the housing market here? Finally, this analysis showed that high-cost borrowers living in low-income areas with high rates of foreclosure were served by a very small number of lenders compared to high-cost borrowers in higher-income areas. Understanding the factors underlying the observed pattern of lending in Cuyahoga County is important in identifying the causes of the foreclosure debacle and the efficacy of proposed remedies and reforms.

The foreclosure problem is a complex one. It likely stems from a number of factors associated with borrowers and lenders, and its resolution likely lies in changes in the behaviors of borrowers and lenders alike. In addition, public officials must carefully sort through the pluses and minuses of options available to them, which include regulatory reform, financial assistance, and programs to gain control of, and rehabilitate, vacant and abandoned properties. Timely research can help inform these decisions.

[1] Cuyahoga County Common Pleas Court data were provided to us by Cleveland State University's Center for Housing Research and Policy. The filings represent an unduplicated count of filings by parcel number in each year. Properties foreclosed upon more than once in a year are only counted once. CSU adds the geographic identifiers such as census tract to the parcel level file. There were 54 foreclosure filings where the address could not be geocoded (assigned geographic identifiers) in 2006 and 65 that could not be geocoded in 2007.

[2] An explanation for the concentration of foreclosures in low- and moderate-income neighborhoods in Cuyahoga County can be found in a recent paper (Atif Mian and Amir Sufi, "The Consequences of Mortgage Credit Expansion: Evidence from the 2007 Mortgage Default Crisis," January 2008, available at <http://ssrn.com/abstract=1072304>). Mian and Sufi find that innovations such as the securitization of subprime mortgages dramatically increased lending in neighborhoods populated by borrowers with lower credit quality.

[3] The city of Cleveland contains 36 neighborhoods, comprised of contiguous census tracts, and the suburbs consist of 59 municipalities.

[4] Foreclosure rates represent the number of foreclosure filings in a given year divided by the number of mortgaged units in that year, for a given geography. The number of mortgaged units in 2006 and 2007 is an estimate based on Census Bureau and American Community Survey data available in 2000 and 2006. The 2006 estimated foreclosure rate for each census tract is obtained by dividing the 2006 number of foreclosure filings in the tract by an estimate of the 2006 number of mortgaged units in that tract. The U.S. Census Bureau provides the 2000 census value for mortgaged units for the tract and for Cuyahoga County. It also provides an American Community Survey estimate of 2006 mortgaged units for the County. Given this information, we apply the County rate of increase to the 2000 census value of mortgaged units in the tract to obtain a 2006 figure of mortgaged units for the tract. To obtain an estimate of the 2007 mortgaged units, we apply the annual average rate of increase between 2000 and 2006 of mortgaged units to the 2006 number of

mortgaged units. The result of that calculation is then added to the 2006 number of mortgaged units to arrive at our estimate of 2007 mortgaged units.

[5] High-cost loans are defined as loans whose rates exceed by at least 3 percentage points the difference between the APR on a loan and the rate on Treasury securities of comparable maturity.

[6] It is not possible to tell from HMDA data whether an individual loan is subprime. However, HUD does identify lenders as subprime specialists, which means they issue mostly (at least half) subprime loans. This lender data can serve as a proxy for the existence of subprime loans in a census tract.

[7] While previous research has examined the link between race and the geographic concentration of high-cost lending and foreclosures, our analysis does not go beyond correlation. Specifically, we do not control for factors that may contribute to higher foreclosure rates, such as educational attainment, family structure, and credit risk. See, for example, William C. Apgar and Allegra Calder, *The Dual Mortgage Market: The Persistence of Discrimination in Mortgage Lending*, Joint Center for Housing Studies, Harvard University, December 2005;. Paul S. Calem, Kevin Gillen and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, *Journal of Real Estate Finance and Economics*, vol. 29, issue 4, October 2002.

[8] Given that many of the tracts within each of the income quartiles are contiguous, the same bank branch is likely to be counted numerous times, because it may lie within a three-mile radius of several of the tracts' geographic centers.

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CREDIT CARD REDLINING



Working Paper No. QAU08-1

Ethan Cohen-Cole
Federal Reserve Bank of Boston

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QAU
WPS No. QAU08-1

Credit Card Redlining

Ethan Cohen-Cole*

February 26, 2008

Abstract

This paper evaluates the presence of racial disparities in the issuance of consumer credit. Using a unique and proprietary database of credit histories from a major credit bureau, this paper links location-based information on race with individual credit files. After controlling for the influence of such other place-specific factors as crime, housing vacancy rates, and general population demographics, the paper finds qualitatively large differences in the amount of credit offered to similarly qualified applicants living in Black versus White areas. An instrumental variables approach allows the paper to distinguish between issuer-provided credit (supply) and utilization of credit (demand), where instruments for demand are derived from social theory à la Veblen (i.e., 'keeping up with the Joneses'). The results suggest that the observed differences in credit lines by racial composition of neighborhood are largely driven by issuer decisions rather than by demand.

JEL codes: J15, G21

Keywords: Credit cards, racial disparities, access to credit, keeping up with the Joneses, African American, redlining

*Cohen-Cole: Federal Reserve Bank of Boston, 600 Atlantic Avenue Boston, MA 02210. (617) 973-3294; email: ethan.cohen-cole@bos.frb.org. Nick Kraninger, Jonathan Larson, and Jonathan Morse provided outstanding research assistance. Bob Avery, Glenn Canner, Yuliya Demyanyk, John Duca, Wendy Edelberg, Robin Lumsdaine, Geoff Tootell, Larry Wall, and seminar participants at the Federal Reserve Bank of Boston, Federal Reserve Board, and the Federal Reserve System Committee on Financial Structure and Regulation provided useful comments. Consumer Credit data has been generously provided by a large credit bureau. Additional thanks are due Glenn Canner for assistance in facilitating this project. The views expressed in this paper are solely those of the author and do not reflect official positions of the Federal Reserve Bank of Boston or the Federal Reserve System.

October 17, 2007

EDITORIAL

Subprime in Black and White

Evidence is mounting that during the housing boom, black and Hispanic borrowers were far more likely to be steered into high-cost subprime loans than other borrowers, even after controlling for factors such as income, loan size and property location.

The Furman Center for Real Estate and Urban Policy at New York University released a study this week highlighting a disturbing pattern of racial disparities. Using data gathered by the federal government, the study showed that the 10 New York City neighborhoods with the highest rates of subprime lending in 2005 had black and Hispanic majorities, while the 10 areas with the lowest rates were mainly non-Hispanic white. The higher incidence of subprime lending to borrowers of color held up even when the median income levels of the neighborhoods were comparable.

And as The Times's Manny Fernandez reported this week, the Furman findings are consistent with a separate analysis of mortgage data by this paper, which found that high-income blacks and Hispanics in New York City were two to three times more likely than comparable non-Hispanic white borrowers to have subprime loans.

Other studies have shown similar racial disparities in Boston, Washington, Philadelphia and other cities.

The bad news doesn't end there. Neighborhoods where subprime borrowers are concentrated are the same neighborhoods that are now experiencing high rates of default and foreclosure. That's because many subprime loans were not designed to be affordable over the long term, but rather to be refinanced before their initial teaser rates rose. That often hasn't been possible as home values have dropped and credit standards have tightened, leaving borrowers stuck in loans that have become unmanageable.

The mortgage lending industry says it's impossible to say that such patterns are the result of discrimination because the federal data do not include so-called risk characteristics like borrowers' credit scores, other debts or how much of a down payment they were able to make.

But the burden of proof has to be on the lenders to show that no discrimination has occurred. They have data on the risk characteristics of their borrowers. When the Federal Reserve began in 2004 to require lenders to provide specific data on subprime loans, the industry fought successfully to keep the risk profile of borrowers, including credit scores, under wraps. Now, with indications of discrimination rife, Congress must demand that data be fully disclosed.

The crisis in subprime lending is already threatening to be a socioeconomic disaster with hundreds of thousands of Americans at risk of losing their homes. Whether there has also been widespread racial discrimination by lenders is a question that lawmakers must confront fully, without delay.

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Mortgage data links higher-priced loans with delinquencies

Racial disparities persist in analysis of loan denials and rates

Thursday, September 13, 2007

[By Matt Carter](#)
[Inman News](#)

A new Federal Reserve Board [analysis](#) of millions of home loans made in 2006 shows a correlation between higher-priced loans that carry heftier interest rates and the rate of serious delinquencies.

As in past years, data collected under the Home Mortgage Disclosure Act revealed blacks and Hispanics were more likely to take out such loans than whites, although it remains a matter of debate whether they are targeted for such loans.

Lenders covered by the act reported receiving 27.5 million home loan applications in 2006, including 14 million refinance loan applications, 10.9 million purchase loan applications and 2.5 million home improvement loan requests. The number of reported applications and purchased loans was down about 6 percent from 2005, driven in large part by a 12 percent decline in refinance applications.

The 8,886 reporting lending institutions -- including 3,900 commercial banks, 946 savings institutions, 2,036 credit unions and 2,004 mortgage companies -- made 14 million mortgage loans, and reported information on 6.2 million loans they purchased from other institutions.

At 29 percent, the denial rate for all home loans in 2006 was up slightly from 27 percent in 2005, but varied greatly by race and ethnicity. For home-purchase loans, the gross mean denial rate was 31.6 percent for blacks, 25.4 percent for Hispanics and 17 percent for Asians, compared with 13.1 percent whites.

Blacks and Hispanics were also more likely to be stuck with higher-cost loans than whites. Under HMDA, higher-cost loans are defined as first-lien loans with annual percentage rates that exceed the interest rate on Treasury securities of similar maturities by 3 percent or more. The threshold for junior loans is 5 percent.

Blacks got higher-cost loans 53.7 percent of the time and Hispanics 46.6 percent of the time in 2006, compared with 17.7 percent of the time for whites. Asians were the least likely of any racial or ethnic group to take out higher-priced loans, at 16.8 percent of the time.

Part of the difference in both denial rates and the incidence of higher-cost loans between ethnic groups can be explained by factors such as property location, income relied on in underwriting, and loan amount, Federal Reserve Board analysts said.

After adjusting for such factors, and factoring in the specific lending institution used by the borrower, the differences between groups were less pronounced.

The adjusted denial rate on purchase loans was 21.5 percent for blacks, 17.5 percent for Hispanics and 14.8 percent for Asians, compared with 13.1 percent for whites. After adjusting for borrower- and lender-related factors, the incidence of higher-cost loans was 30.3 percent for blacks, 24 percent for Hispanics, and unchanged for Asians and whites.

The reason for the remaining, unexplained disparities between different racial and ethnic groups may lie with other criteria lenders use in making underwriting decisions, but which is not collected under HMDA -- including credit scores, loan-to-value and debt-to-income ratios, and differences in the choice of loan

product.

"Differences in pricing and underwriting outcomes may also reflect discriminatory treatment of minorities or other actions by lenders, including marketing practices," the study noted. "Further research is needed to assess the extent to which credit- or cost-related factors account for the unexplained differences in loan pricing and denial rates."

After the Federal Reserve released HMDA data for 2005, a number of groups released their own [studies](#), many of which gave greater credence to the likelihood that lenders were discriminating against minorities.

The U.S. Department of Justice has [said](#) it uses HMDA data to investigate whether minorities are targeted for higher-priced loans.

With a rise in delinquencies and foreclosures disrupting mortgage lending and financial markets, the Federal Reserve's analysis of 2006 HMDA data also looked at whether higher-cost loans are associated with increased delinquencies.

An examination of delinquency rates at the end of March conducted at the metropolitan statistical area county level showed that, in general, areas with elevated rates of higher-priced lending also had elevated rates of serious delinquencies of 90 days or more.

Exceptions were parts of Florida, California and the middle Atlantic region where higher-priced lending was rampant, but which had moderate levels of serious delinquencies. Since the comparison was made, some of those areas have seen sharp increases in delinquency rates.

There were also many counties in Michigan, Indiana, Ohio, Colorado, western Pennsylvania and the south Atlantic region where the rate of higher-priced lending was not unusually high, but where delinquency rates were elevated because of economic conditions.

All in all, the results of the analysis suggested that the incidence of higher-priced lending can be a predictor of loan performance. An increase in the incidence of higher-priced lending of 1 percentage point implies an increase in the rate of serious mortgage delinquency of .03 percent, the study found.

"Although the effect may seem small, it is, in fact, fairly large given the relatively low level of mortgage delinquency," the study concluded. In a county with the median level of serious delinquency, 1.27 percent, a 10 percent increase in the incidence of higher-priced lending could push delinquency rates into the next "quintile," or between 1.46 percent and 1.91 percent."

* * *

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May 7, 2007

Study: Blacks Pay Higher Auto Loan Rates

By THE ASSOCIATED PRESS

Filed at 5:10 p.m. ET

WASHINGTON (AP) -- Blacks have been charged higher auto loan rates than other auto buyers, federal research says. But the gap in loan rates could narrow, and possibly disappear, as the result of recently concluded lawsuits.

Blacks paid a typical auto loan rate of 7 percent for new cars, compared with a rate of 5 percent for whites in 2004, according to a consumer organization's analysis of the Federal Reserve Survey of Consumer Finances. That was the most recent survey available.

And blacks were more likely than auto buyers in general to have auto loan rates higher than 15 percent. For used car loans, 27 percent of blacks who buy cars were charged interest rates of 15 percent or more. Blacks were three times as likely as whites -- 27 percent to 9 percent -- to have auto loan rates at least that high, according to the report released Monday.

Hispanics were paying a typical rate of 5.5 percent for new car loans, while 19 percent of Hispanics had loans for used cars over 15 percent, the analysis found.

Lenders' suggested quote rates are based largely on the buyer's credit history, but auto dealers often raise the rate higher than that risk-related rate without discussing the rate with the customer, consumer advocates said. And they question the causes of those rate differences.

"It's hard to believe that any differences in creditworthiness explain all of these rate gaps," said Stephen Brobeck, executive director of the Consumer Federation of America. "They size you up, the car salesmen and finance and interest guys. They must think African-Americans are more vulnerable to a markup."

But a series of legal actions against auto finance firms seeking fair treatment for minorities could help solve that problem.

"We had 11 lawsuits, the last of the cases settled last month," said Stuart Rossman of the National Consumer Law Center. "We reached a settlement with each of the finance firms. Our cases involved discrimination. We believe the terms of the settlements will eliminate discrimination."

The first of the lawsuits was filed in 1998 in Nashville, Tenn., against General Motors Acceptance Corporation and was settled in 2004. The last settlement became final in April.

The effects of those legal actions may not be known for some time, however.

The National Auto Dealers Association questioned what accounts for the rate differences, but encouraged auto buyers to do their homework before going to buy a car.

"The question that still is unanswered is why," said David Hyatt, a spokesman for the dealer's association.

"People should do their homework and shop around. It speeds up the transaction, makes for a smoother transaction and is more likely to result in a satisfied buyer."

Hyatt said an organization supported by the auto dealers, Americans Well Informed on Automobile Retailing Economics (AWARE), offers tips to potential car buyers.

Chris Stinebert, president and chief executive of the American Financial Services Association, said his group is interested in educating consumers.

"AFSA and its members believe there is no place for discrimination in the vehicle financing system," he said.

The lawsuit settlements against auto finance companies call for caps on dealer markups, opportunities for blacks and Hispanics to get loans with no markups within the next few years, more information about interest rate terms and consumer education for minorities.

"The lower markup caps have leveled the playing field," Rossman said.

Consumer advocates say prospective auto buyers should call their bank or credit union for a rate quote to expect on an auto loan. That could protect them from unfair markups.

Other ways to hold down costs.

--Make all loan payments on time.

--Buy a used car, or a less expensive new car.

--Take out a loan over a shorter time.

The survey of 4,519, including 605 blacks, was analyzed by Catherine Montalto, a consumer specialist at [Ohio State University](#) for the Consumer Federation of America. The survey was conducted between May and December of 2004.

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On the Net:

Consumer Federation of American: <http://www.consumerfed.org>

National Consumer Law Center: <http://www.consumerlaw.org>

National Automobile Dealers Association: <http://www.nada.org>

AWARE: <http://www.autofinancing101.org>

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November 4, 2007

THE NATION

What's Behind the Race Gap?

By [VIKAS BAJAJ](#) and [FORD FESSENDEN](#)

High-cost subprime mortgages have often been framed as loans that catered to people with blemished credit records or little experience with debt.

There has been less attention paid to the concentration of these loans in neighborhoods that are largely black, Hispanic, or both. This pattern, documented in federal loan records, holds true even when comparing white middle-income or upper-income neighborhoods with similar minority ones.

Consider two neighborhoods in the [Detroit](#) area. One, located in the working-class suburb of Plymouth, is 97 percent white with a median income of \$51,000 in 2000. To the east, a census tract in Detroit just inside Eight Mile Road has a very similar median income, \$49,000, but the population there is 97 percent black.

Last year, about 70 percent of the loans made in the Detroit neighborhood carried a high interest rate — defined as 3 percentage points more than the yield on a comparable Treasury note — while in Plymouth just 17 percent did.

Last year, blacks were 2.3 times more likely, and Hispanics twice as likely, to get high-cost loans as whites after adjusting for loan amounts and the income of the borrowers, according to an analysis of loans reported under the federal Home Mortgage Disclosure Act. (Asians are somewhat less likely than whites to take out high-cost loans.)

Researchers and industry officials agree that there is probably no single explanation for the lending patterns, though the history of banks' avoiding minority neighborhoods, the practice known as "redlining," is a good place to start. (Experts have to resort to guesswork because the government does not require lenders to report information about borrowers' credit scores, down payments and other details used in pricing loans.)

Lenders say that in general higher rates are justified to account for the bigger risks posed by borrowers who have a poor record at paying bills on time and defaulting on debts. And a recent Federal Reserve study noted that neighborhoods where people tend to have lower credit scores also tend to a greater concentration of high-cost loans.

The study suggests that the concentration of high-cost loans is not caused by an area's racial makeup, though there is a correlation, said Jay Brinkmann, vice president for research and economics at the Mortgage Bankers Association.

But the Fed study also suggests that a big part of the reason may have to do with the lenders that minority borrowers do business with. The biggest home lenders in minority neighborhoods are mortgage companies

that provide only subprime loans, not full-service banks that do a range of lending.

It may be that these borrowers do not have access to traditional banks, because there are no branches near them. The Community Reinvestment Act, enacted 30 years ago, was intended to address redlining by forcing banks to make loans in lower-income areas. But the law's provisions do not apply to banks in neighborhoods where they have no branches.

"You could go into a middle-class area in Queens County that is white and there will be lots of banks on the shopping street," said Alfred A. DelliBovi, president of the Federal Home Loan Bank of New York and a deputy secretary of the [Department of Housing and Urban Development](#) in the first Bush administration. "If you go to an area that is equal income and that is black, you won't see many."

Banks typically locate branches where they believe they will get the most deposits. A lower savings rate and a distrust of banks stemming from a legacy of redlining may help explain why there are fewer branches in minority neighborhoods, Mr. DelliBovi said.

A bigger reason may be that in recent years many subprime loans were not sought out by borrowers but actively sold to them by brokers and telemarketers, said Calvin Bradford, a housing researcher and consultant. A majority of the loans were refinance transactions allowing homeowners to take cash out of their appreciating property or pay off credit card and other debt.

Lenders made the risky loans, then often sold them to Wall Street investors. Many borrowers appear to have been swayed by brokers and lenders offering to look out for their best interests even when they had no obligation to do so.

"If we turn the clock back 30 years ago, we had redlining," said Nicholas Retsinas, director of the Joint Center for Housing Studies at [Harvard University](#). "In the last few years, we have had the opposite — an overextension of credit by lenders and an overextension by borrowers."

The country needs to find a balance, "a way to extend credit at a reasonable cost to people with impaired credit," he said. The government, through programs like the Federal Housing Administration and the big mortgage purchasers Fannie Mae and Freddie Mac, must play a critical role, Mr. Retsinas said, adding that he worries that the efforts initiated so far are not robust enough.

"There are lots of people trying to do the right thing," he said. "But at this time I'm not very sanguine that we will deal with this in a concerted manner."

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THE WALL STREET JOURNAL

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APRIL 13, 2009

Bailed-Out Banks Face Probe Over Fee Hikes

By DAVID ENRICH, MARSHALL ECKBLAD and MAURICE TAMMAN

The committee overseeing federal banking-bailout programs is investigating the lending practices of institutions that received public funds, following a rash of complaints about increases in interest rates and fees.

Since the Troubled Asset Relief Program was launched last October, banks bolstered by capital infusions have boosted charges on a wide range of routine transactions, hiked rates on credit cards and continued making loans criticized as predatory by consumer advocates. The TARP funds are intended to open lending spigots and make it easier for people to borrow money.

Last week, for example, [Bank of America Corp.](#) told some customers that interest rates on their credit cards will nearly double to about 14%. The Charlotte, N.C., bank, which got \$45 billion in capital from the U.S. government, also is imposing fees of least \$10 on a wide range of credit-card transactions.

[Citigroup Inc.](#), another recipient of government cash, is trying to entice customers to borrow at high rates. "You could get \$5,000 today," Citigroup's consumer-finance unit wrote in fliers mailed to customers. The ads don't disclose that the loans often carry annual interest rates of 30%.

The interest rates "compare competitively to similar offers in the market" and vary depending on the creditworthiness of borrowers, a Citigroup spokesman said. Citigroup has received \$50 billion in capital from taxpayers, and the U.S. government will soon own as much as 36% of the company's common stock.

"To continue to offer competitive products and services and responsibly lend in this current environment, we must adjust our pricing," said a Bank of America spokeswoman about the company's new fees and interest rates.

The U.S. government's ownership stakes in hundreds of banks, as well as political ire stoked by lucrative pay and perks, are raising the specter of new regulation on basic banking practices. First-quarter results due starting this week will be scrutinized for signs of how much taxpayer-funded capital is being funneled into loans.

Elizabeth Warren, chairwoman of the Congressional Oversight Panel, the body named by Congress to oversee the federal bailout, said the panel is working on a report examining instances of potentially inappropriate lending by banks that got taxpayer capital. "The people who are subsidizing the activities of the banks through their tax dollars are the same people who are furnishing the high profits through consumer lending," Ms. Warren said in an interview. "In a sense, we're asking taxpayers to pay twice."

Last month, a Senate committee narrowly approved a bill that would rein in many credit-card marketing and pricing policies, including ballooning interest rates. Proponents of the legislation say many of the largest card issuers have received government aid and so should be subject to greater scrutiny.

Banks say that raising fees and rates, even on low-risk customers, is a legitimate way to recoup some of the costs of the bad loans still on their books. They also say taxpayers have a financial interest in seeing the industry quickly return to profitability. Any revolt over price hikes could intensify the crisis by depriving institutions of a key income source, say banks. New restrictions on these lending practices "may truly have an impact on profitability," said Gerard Cassidy, a bank analyst with RBC Capital Markets.

The controversy underscores the quandaries of Washington's dual role as owner and overseer of U.S. banks. While

October 29, 2008

As Economy Slows, Lenders Begin to Curb Credit Cards

By [ERIC DASH](#)

First came the mortgage crisis. Now comes the credit card crunch.

After years of flooding Americans with credit card offers and sky-high credit lines, lenders are sharply curtailing both just as an eroding economy squeezes consumers.

The pullback is affecting even credit-worthy consumers and threatens an already beleaguered banking industry with another wave of unprecedented losses after a gilded era in which it reaped near-record gains from the business of easy credit that it helped create.

Lenders wrote off an estimated \$21 billion in bad credit card loans in the first half of 2008 as borrowers defaulted on their payments. With companies laying off tens of thousands of workers amid the crisis, the industry stands to lose at least another \$55 billion over the next year and a half, analysts say. Currently, the total losses amount to 5.5 percent of credit card debt outstanding, and could surpass the 7.9 percent that occurred after the technology bubble burst in 2001.

"If unemployment continues to increase, credit card net charge-offs could exceed historical norms," Gary L. Crittenden, [Citigroup](#)'s chief financial officer, said.

Faced with sobering conditions, companies that issue [MasterCard](#), [Visa](#) and other cards are rushing to stanch the bleeding, even as options once easily tapped by borrowers to pay off credit card obligations, such as home equity lines or the ability to transfer balances to a new card, dry up.

Big lenders — like [American Express](#), [Bank of America](#), Citigroup and even the retailer Target — have begun tightening standards for applicants and are culling their portfolios of the riskiest customers. [Capital One](#), a big issuer, for example, has aggressively shut down inactive accounts and reduced customer credit lines by 4.5 percent in the second quarter from the previous period, according to regulatory filings.

Lenders are shunning consumers already in debt and cutting credit limits for existing cardholders, especially those who live in areas ravaged by the housing crisis or work in troubled industries. In some cases, certain lenders are even pulling in credit lines after monitoring cardholders who shop at the same stores as other risky borrowers or who have mortgages from certain banks.

While such changes protect banks, some can come back to haunt consumers. The result can be a lower credit score, which forces a borrower to pay higher interest rates and makes it harder to obtain loans. A reduced line of credit can also make it harder for consumers to manage their budgets since lenders have 30 days to notify their customers, and often do so only after taking action.

The depth of the [financial crisis](#) has shocked a credit-hooked nation into rethinking its habits. Many families once content to buy now and pay later are eager to trim their reliance on credit cards. The Treasury Department, which is spending billions in taxpayer money to clean up an economic mess triggered in part by all sorts of easy credit, recently started an advertising campaign inviting consumers to check into the “Bad Credit Hotel,” an online game that teaches the basics of maintaining good credit.

At the same time, the fear factor among lenders has deepened just as the crisis makes it harder for some financially stretched consumers to wean themselves from credit cards for even basic needs, like gas and food.

“We are not going to say, yahoo, this is over and extend credit like we did without fear,” [Jamie Dimon](#), [JPMorgan Chase](#)’s chief executive, said on a recent conference call. “If you’re not fearful, you’re crazy.”

The credit worthy are no exception. American Express, which traditionally catered to more upscale cardholders, said it would be increasing the effective interest rates by 2 or 3 percentage points for a broad range of its credit card holders — a move that could, for example, push a 15 percent rate up to 18 percent.

“We think it’s prudent given the nature of those products and the economic environment we face,” Daniel Henry, its chief financial officer said on a recent conference call.

Some reward programs have also gotten stingier as lenders cut corners to save money. Card companies, for example, have taken to substituting [Sony](#) big-screen television with a cheaper brands as a way of lowering the cost of their redemption prizes.

For less credit-worthy customers, issuers are pulling back on promotional offers that allowed borrowers to pay no interest for months as they try to get ahead of stiffer lending rules that have been proposed by federal banking regulators and Congress.

The regulations, while beneficial to consumers, will curb profits on their riskiest customers. JPMorgan said that it was withdrawing some of its teaser-rate loans that were only marginally profitable. Discover Financial shortened the duration of its zero-balance offers.

And lenders, overall, are slowing the flood of mail offers to a trickle with moves that would translate for the average American household into about 13 fewer pieces of credit card junk mail a year than its peak in 2005. Mail offers to new and existing customers are on pace to drop below 8.4 billion pieces, the lowest level since 2004, according to Mintel Comperemedia, a direct marketing research firm.

Online credit card applications have fallen for the first time in five quarters, in part because customers are receiving fewer mail offers that drive them to the Web, according to data from ComScore, an Internet marketing research firm.

“We used to get a couple of offers a week, but I haven’t seen a credit card offer in over a year,” said Brett Barry, who owns a real estate agency outside Phoenix and described his credit record as strong. “What blows me a way is these companies are in the business of extending credit, but they don’t want to do it for me.”

Mr. Barry said that, without any notice, American Express has reduced the credit limit on his business and

personal credit card at least four times in the last year, which he said had lowered his credit score. The moves have also made it difficult for him to manage his payroll and budget, he said.

“Credit card issuers have realized their market is shrinking is that there is no room for extra credit cards, so they have to scale back,” said Lisa Hronek, a research analyst at Mintel. “People are completely maxed out with mortgages, home equity lines and credit card debt.”

At the same time, credit card profit margins have been narrowing, largely because lenders’ own financing costs remain elevated as investors spurn credit card bonds, just as they did mortgages. Another factor is that the interest rates banks charge even credit-worthy borrowers, meanwhile, had come down in the wake of emergency actions taken by the Federal Reserve to ease the credit crisis.

Meanwhile, bank executives say consumers are starting to pull back on spending, a pattern that may become clear Wednesday when Visa reports its third quarter results.

In previous downturns, banks could make up the missing profits by raising fees. This time, there may be less room to maneuver.

“The last time credit costs spiked, the late fees were much lower so card issuers could turn to that and re-price more nimbly,” a [Morgan Stanley](#) analyst, Betsy Graseck, said. “There is just more scrutiny now, and coming after subprime the mortgage crisis, the world is more sensitive to the way lenders behave.”

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The Washington Post

Low Price, Low Rate, Sky-High Fees

By Kenneth R. Harney
Saturday, April 18, 2009

House prices and mortgage rates are down, which sounds great for buyers and refinancers. But a series of underwriting and appraisal changes taking effect this month is throwing new obstacles in the way of borrowers and loan officers.

Take Fannie Mae's and Freddie Mac's add-on fees for loans purchased after April 1. In some cases, applicants are being hit with extra fees of 3 percent to 5 percent because of the type of property they want to buy or refinance, their credit scores, or the size of their down payment.

Some major lenders that sell loans to Fannie and Freddie are going further -- tightening underwriting rules beyond what either corporation requires. For example, as of April 6, Wells Fargo, one of the country's largest mortgage originators, imposed a minimum FICO credit score of 720 -- up from the previous 620 -- on all conventional loans purchased through its wholesale system that have less than a 20 percent down payment. It also began requiring a total-debt-to-income ratio maximum of 41 percent, down from the previous 45 percent.

Fannie Mae now has a mandatory fee of three-quarters of a point on all condominium loans, no matter how high the applicant's credit score. For a once-popular "interest-only" condo loan with a 20 percent down payment and a borrower credit score of 690, Fannie imposes the following ratcheted sequence of add-on fees: 0.25 percent as an "adverse market" fee, 1.5 percent for the below-optimal credit score, 0.75 percent for the interest-only payment feature and 0.75 percent because the property is a condo. The total comes to 3.25 percent extra, which can be paid upfront or rolled into the rate.

On top of the extra fees from Fannie and Freddie, borrowers are now starting to get hit with two sets of cost-raising appraisal rule changes. Fannie and Freddie have begun requiring all appraisers to complete an extra "market condition" report that includes detailed statistical analyses of local sales and pricing trends, beyond the regular appraisal data. Many appraisers are charging an extra \$45 to \$50 for the time required to complete the form. Both home buyers and refinancers can expect to pay the higher fees.

On top of that, beginning May 1, Fannie and Freddie will refuse to fund loans with appraisals that do not follow a set of new rules known as the "home valuation code of conduct." Among the procedural changes: Mortgage brokers no longer can order appraisals directly but instead must allow lenders or investors to use third-party "appraisal management companies" to assign the job to appraisers in their networks.

How does that affect the consumer? Consider the notification one Connecticut brokerage firm recently received from a major lending partner: Starting April 15, all good-faith estimates provided to applicants must indicate a flat \$455 charge for appraisals arranged through the appraisal management company.

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The broker previously charged \$325. Consumers will now have to pay the appraisal fee upfront, before any inspection or valuation is completed.

What happens if the appraisal comes in low and the applicants can't qualify for the refi or purchase program they sought? Tough luck: They'll have just two choices: Either pay another \$455 for a second appraisal, with no assurance that it will solve the problem, or cancel the application.

Jeff Lipes, president of Family Choice Mortgage, which serves the Hartford, Conn., area, said the effect of the underwriting, credit-score and pricing changes is to "squeeze some people who are creditworthy by any reasonable standard out of the market."

For instance, as a result of the restrictions on condos, Lipes said, "whenever we hear the word 'condo,' we shiver" because the deck is stacked against loan applicants.

Even for prime borrowers with 800 FICO scores and 50 percent down payments, Lipes said, "I can't tell them that we're certain we can get you a mortgage." A welter of recent rule changes from Fannie Mae have made some condo units in projects with commercial tenants or high percentages of investor units almost impossible to refinance.

In Naples, Fla., John Calabria, president of BancMortgage, said, "It has become such a nightmare to lend money" because of the layers of add-on fees and higher mandatory down payments and credit scores. One high-income client sought to put down \$200,000, or 25 percent, to buy an \$800,000 condo as a second home but couldn't because the minimum down payment on such a unit is now 30 percent.

"That's ridiculous," Calabria said. "Some of this just doesn't make sense."

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Credit score formulas not changing as credit limits slashed

Fair Isaac, VantageScore take wait-and-see approach to economic crisis



By Jeremy M. Simon

Credit card issuers' recent decisions to trim credit limits has lowered millions of consumers' credit scores. But the companies that create credit scores say they feel no obligation to adjust their credit scoring formulas to recognize the new credit landscape.

In recent months, major credit card issuers have sharply lowered limits on credit cards in an effort to stem the losses inflicted by sharp cardholder delinquencies. A Nov. 3, 2008, [Federal Reserve survey of senior loan officers](#) showed that about 20 percent of banks had reduced consumers' existing credit card limits for prime borrowers, while about 60 percent reduced limits on nonprime borrowers. A Federal Deposit Insurance Corp. [report](#) says those reductions in credit limits -- by cutting or closing consumers' credit card accounts -- totaled \$123 billion in the third quarter of 2008.



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Credit cardholders, even those who consistently pay their card bills on time, have as a result seen credit scores lowered.

Lowering credit limits automatically reduces many consumers' credit scores because it changes a key ratio that Fair Isaac Corp. and VantageScore -- the chief suppliers of credit scores -- use in calculating scores. In the credit scoring formulas, having a high amount of unused credit says you're a responsible borrower. Having a high amount of unused credit is rewarded with a higher credit score. Lowering that ratio lowers credit scores.

A revised version of Fair Isaac's credit scoring formula has been in the works for some time but is finally set for use by the three major credit bureaus starting in 2009. However, it likely won't do anything to address the problems of those whose scores have been hurt by slashed credit limits. According to Fair Isaac spokesman Craig Watts, the new formula will make "subtle changes" to the way FICO scores assess credit risk, but Watts says that none of the changes will alter how consumers can improve their credit scores. In other words, borrowers who have their credit limits slashed probably shouldn't expect a reprieve at the hands of Fair Isaac, even though a Dec. 18, 2008, press release underscores the significance of the issue, saying, "If your credit card balances are close to your credit limits, budget your finances to make debt reduction a top priority. Your indebtedness is the second-most important factor for FICO scores."

Credit line reductions may come as a surprise to cardholders, regardless of whether they find out about them from a bank letter or a penalty charge. "Some know when they get the notice, and some know when they get the over-the-limit fees," says Gail Hillebrand, spokeswoman for consumer advocacy group Consumers Union, noting that some consumers are seeing credit limits reduced to the amounts they owe their lenders.

Even cardholders who maintain balances below their new credit limits may suffer. Since part of the mathematical formula used to [calculate a borrower's credit score](#) -- which helps lenders determine whether to give a potential borrower money and at what interest rate -- depends on the ratio of how

much credit a borrower has access to versus how much the consumer is using, lowered limits could trigger higher borrowing costs.

Fair Isaac and VantageScore acknowledge this fact. However, when it comes to lowered limits, Fair Isaac's Watts says that although data (rather than more subjective factors) drives any changes to its scoring model, the company will "continue to analyze this industry activity and any potential impact on FICO scores going forward." VantageScore has a similar response. "At VantageScore, we regularly examine our model to see the effect that changing economic and environmental conditions play in the determination of consumer scores," VantageScore Solutions President and CEO Barrett Burns says in a statement. Fair Isaac is the creator of the popular FICO credit score, while VantageScore is a joint venture between three major credit bureaus: Equifax, Experian and TransUnion.

Credit scores are still a bit of a black box.

— Gail Hillebrand
Consumers Union spokeswoman

Nobody move and nobody gets hurt

Fair Isaac and VantageScore say that lowered credit limits are unlikely to hurt the bulk of borrowers. According to Watts, Fair Isaac's ongoing research "shows that lenders have reduced the credit limits for

revolving accounts for a relatively small population, and those line reductions have been a relatively small amount for a sizeable part of that population." VantageScore's Burns also downplays the lowered limits. "While utilization accounts for a part of each consumer's credit score, there are multiple consumer behaviors that contribute to a credit score, with payment history remaining as the largest contributing factor," he says via a statement.

Consumer Union's Hillebrand disagrees. "It's always a little misleading to say it's only going to affect a small number of people," she says. "The overall statistics could mask the real harm to individual households." Banks contacted for this story were largely unwilling to comment, although [Bank of America](#) indicated that FICO is just one of many factors it considers when making lending decisions.

For Hillebrand, the harm comes from the way a jump in utilization rates could translate into steeper borrowing costs. She notes that consumers who have spoken with her organization are reporting sizable cuts to their credit limits, in some cases amounting to a 40 percent or 50 percent reduction from their earlier lines of credit. That means consumers using 30 percent of a credit line may quickly find themselves with a new utilization rate of 60 percent. "If it happens to you, it's going to hurt you," Hillebrand says.

Other factors are important

How badly it hurts varies. "FICO scores assess a wide variety of data on credit reports, so the impact to the score by a single factor like credit limit reductions will depend on what other data is on the credit report and the amount of the credit line reduction," says Watts. "The person's score could be unchanged, it could go down or in some cases it could go up." That's because a borrower's credit utilization doesn't exist in a scoring vacuum. "Just reducing credit limits by themselves, or raising credit limits, for that matter, has no impact on credit scores," Watts says.

VantageScore's Burns echoes those thoughts. "The effect of each of these factors on individuals' credit scores varies based on the consumers' unique debt management behaviors. This means that the reduction of a credit line does not impact individual scores in the same manner with every consumer. The majority of consumers could see very little impact, while others may see more change," Burns says. "There are too many variables to provide definitive answers to hypothetical questions regarding factors, including reduced credit limits, that might affect a consumer's credit score," he says.

The difficulty is knowing how those factors combine to move a credit score in one direction or the other. "Credit scores are still a bit of a black box," Hillebrand says, adding that many consumers are potentially still largely unaware of how credit limits play into the calculation of credit scores. Even for consumer advocates, the impact on a credit score is difficult to decipher. Ed Mierzwinski, consumer program director for U.S. PIRG, agrees that while the lowering of a credit limit increases the borrower's utilization of available credit, "The question is how much. The high priests of the secretive Fair Isaac cult usually don't spring for such details," he says.

Fair Isaac can't say exactly how utilization ratios impact individuals. While the "amounts owed" portion of the credit score model accounts for 30 percent of an average borrower's score, individual actual results may vary. That weighting "may be considerably higher than 30 percent for some consumers and considerably lower for some consumers," Watts says.

Low-risk borrowers more likely to suffer

The move to cut credit limits may have the greatest impact on the credit scores of higher-quality cardholders who carry a balance on their credit cards. People who have good credit scores "are more likely to experience a deterioration in their credit score due to a drop in limits," Hillebrand says. That's because what could amount to just another minor negative for consumers with really poor scores could be more a more damaging black mark on generally clean credit histories, she explains. Fair Isaac's Watts modifies this somewhat, noting that bad credit histories may put some borrowers' closer to lowest possible FICO scores, while those lower-risk cardholders' high credit scores have more room to fall.

It doesn't matter if their score was low or high to start with. It matters whether they carry high balances on that or other accounts.

*-- Craig Watts
Fair Isaac spokesman*

Fair Isaac says the impact is more about whether cardholders are revolvers than if they have a high or low credit score. "The population most at risk is going to be that population that carries a high balance," Watts says. "It doesn't matter if their score was low or high to start with. It matters whether they carry high balances on that or other accounts." The history of a borrower's limit on one credit account is irrelevant, Watts says, since Fair Isaac's model is a snapshot of overall credit usage and doesn't consider if individual credit lines have been altered.

Take action

While cardholders can't do much to prevent their credit limits from coming down, there are steps they can take to protect themselves.

- **Pay down debt.** By paying off debt, which reduces their use of credit, borrowers can re-balance their credit utilization ratios. "In general, you want your ratios as low as possible, and definitely less than 50 percent," U.S. PIRG's Mierzwinski says. Fair Isaac's Watts concurs with that approach. "If you have low balances going into it, it's not going to be a big deal. If you have high balances, pay down those balances," he says.
- **View your credit report.** Because changes to a credit limits can affect consumers differently, it's important for borrowers to consider their situations as spelled out in the explanations that accompany credit scores. "Pay attention to what's holding your particular score back" and work to correct the problem, Watts says. "If the explanation says nothing about high balances, then you don't need to worry about that."
- **Opt out.** If higher interest rates do follow a lowered credit score, cardholders should ask their issuer about [opting out](#) -- paying off their balances at the current APRs. Cardholders who opt out will be unable to continue making purchases with their card.
- **Practice good borrowing habits.** Even if limits change, responsible behavior shouldn't. "To maintain a good VantageScore or to improve it over time, we encourage prudent borrowing in relation to a borrower's ability to keep payments current; applying for credit only when it's needed; not opening new accounts frequently or opening multiple accounts within a short time span; and paying any delinquent accounts as soon as possible, then keeping them current," Burns says.

Outside assistance

Cardholders could get some relief from [new credit card regulations](#) approved Dec. 18 by federal banking regulators. The rules prevent issuers from boosting interest rates on money that has already been borrowed, even if the cardholder's credit score falls. However, the rules don't take effect until July 2010.

Other relief could come from a less likely source: the banks themselves. Hillebrand says banks could step up and acknowledge that "we caused this problem, and we're not going to ding you for it," she says. Since a bank could conceivably lower a cardholder's credit limit -- thereby reducing his or her

credit score -- and then turn around and boost the borrower's APR due to that very same drop in the credit score, banks themselves can offer a solution. "They could waive their universal default clauses when they cause the default," Hillebrand says. Under [universal default](#), banks have the ability to hike cardholders' APRs based solely on their declining credit scores.

In the end, the currently unfolding situation may be less about credit limits and more about lending decisions that the banks are now trying to undo. "We are not saying high credit limits are a good thing," Hillebrand says. However, the decision to now lower credit limits is a result of overzealous lending that is now causing a spike in defaults. "Someone didn't do their homework on the front end," she says, "and that someone is the lender."

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Credit card issuer actions could lower scores; now what?

03.10.09

By John Ulzheimer

Last week, Credit.com released the results of a [survey](#) that validated what many in the credit industry already suspected, which was that many consumers are seeing the terms of their credit card accounts adversely modified. The results showed that 33.7 percent of the consumers surveyed saw their credit card issuer lower their credit limit; increase their interest rate; increase their monthly payment; change their payment due date; close the account; or reduce their rewards program in some way. And although not a component of the survey, in many cases these changes are being made for some reason other than the cardholder mismanaging the account.

For example, I recently received this email from a consumer:

Hi John, just thought I'd give you another story of a credit card company raising rates despite an excellent FICO score. Mine is 802 and I pay my cards in full each month. And this week Cap One sent notice of a rate increase from a "fixed" 6.9% to variable prime + 12.65% effective next January. Until then they are considering the 6.9% a promotional rate. Their justification was the "extraordinary economic times and the length of time I've had the rate and my acct."

In this example, the consumer has a choice to make. He can do nothing, leaving the card open and using the account under the new terms. Alternatively, he can pay off his balance, close the account, and move on. Or he can pay off the card, leave it open, and stop using it. What's best for his credit scores might not be what he wants to hear, which is to leave it open.

As identified in our survey, the issue at hand with many of the actions taken by issuers, is that these imposed changes can lower consumers' credit scores. Lowering limits and closing the account are the most obvious actions that can leave you with a lower score. But, any of the other actions can certainly act as an incentive to close the account on your own, perhaps during a moment of anger, a self-imposed change that can lower your scores further.

It's best to divorce yourself from emotion when making any decision this important. If you do choose to close the card, it's best to open a new one and try to replace the lost credit limit. Or, if you can live with it, leave the card open and simply don't use it. But in this case, you run the risk that the issuer will close it because of inactivity. The best option is to pay it off, leave it open, and use it periodically for small purchases. This ensures activity, no interest, and a little credit score insurance.

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Credit-card industry may cut \$2 trillion lines: analyst

Mon Dec 1, 2008 4:06pm EST

(Reuters) - The U.S. credit-card industry may pull back well over \$2 trillion of lines over the next 18 months due to risk aversion and regulatory changes, leading to sharp declines in consumer spending, prominent banking analyst Meredith Whitney said.

The credit card is the second key source of consumer liquidity, the first being jobs, the Oppenheimer & Co analyst noted.

"In other words, we expect available consumer liquidity in the form of credit-card lines to decline by 45 percent."

Bank of America Corp (BAC.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)), Citigroup Inc (C.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) and JPMorgan Chase & Co (JPM.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) represent over half of the estimated U.S. card outstandings as of September 30, and each company has discussed reducing card exposure or slowing growth, Whitney said.

Closing millions of accounts, cutting credit lines and raising interest rates are just some of the moves credit card issuers are using to try to inoculate themselves from a tsunami of expected consumer defaults.

A consolidated U.S. lending market that is pulling back on credit is also posing a risk to the overall consumer liquidity, Whitney said.

Mortgages and credit cards are now dominated by five players who are all pulling back liquidity, making reductions in consumer liquidity seem unavoidable, she said.

"We are now beginning to see evidence of broad-based declines in overall consumer liquidity."

"Already, we have witnessed the entire mortgage market hit a wall, and we believe it will, for the first time ever, show actual shrinkage over the next few months," she wrote.

The credit card market will be 18 months behind the mortgage market and will begin to shrink by mid-2010, Whitney said.

Whitney also expects home prices to continue falling another 20 percent hurt by lower liquidity. They are down 23 percent from their peak, she said.

"In a country that offers hundreds of cereal and soda pop choices, the banking industry has become one that offers very few choices," Whitney wrote in a note dated November 30.

She also said credit lines to consumers through home equity and credit cards had been cut back from the second-quarter levels.

"Pulling credit when job losses are increasing by over 50 percent year-over-year in most key states is a dangerous and unprecedented combination, in our view," the analyst said.

Most of the solutions to the situation involve government intervention, and all

of them require more dilutive capital to existing lenders, she said.

"Accordingly, we continue to be cautious on our outlook on US banks."

SUGGESTIONS

In a column in the Financial Times, Whitney suggested four adoptable changes to make a difference.

The first would be to re-regionalize lending, which has gone from "knowing your customer" or local lending, to relying on what have proven to be unreliable FICO credit scores and centralized underwriting, due to the nationwide consolidation since the early 1990s, she wrote in the column.

Expanding the Federal Deposit Insurance Corp's guarantee for bank debt will also help as the banks need to know they can access reasonably priced credit for an extended period to continue to extend new credit lines, she wrote in the column.

Whitney also advised delaying the introduction of new accounting rules, which would bring off-balance-sheet assets back on balance sheet, until 2011 or 2012, as the primary assets that will come back are credit card loans.

Whitney suggested amending the proposal on Unfair and Deceptive Lending Practices that is set to be adopted in 2010, saying restricting lenders' ability to reprice an unsecured loan will cause them to stop lending or to lend less.

(Reporting by Neha Singh and Amiteshwar Singh in Bangalore; Editing by Vinu Pilakkott, Jarshad Kakkarakandy)

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The Washington Post

Congress Takes Aim at Credit Card Lending

Tuesday, April 21, 2009

President Obama is "broadly supportive" of two bills in Congress that would curb abusive practices of credit card companies, according to administration officials. Here are some of the provisions.

In the House

Carolyn Maloney's (D-N.Y.) Credit Cardholders' Bill of Rights:

- Prevents card issuers from increasing interest rates on existing balances unless a cardholder is more than 30 days late, a pre-agreed promotional rate expires, the rate adjusts as part of a variable rate or the cardholder fails to comply with a workout agreement.
- Requires companies to let consumers set their own fixed credit limit.
- Limits to three the number of over-the-limit fees that companies can charge for the same transaction.
- Ends "double-cycle" billing, the practice of charging interest on debt consumers have already paid on time.
- Prohibits card companies from charging a fee for payments made over the phone or online.
- Requires payments made in excess of the minimum to be allocated proportionally or to the balance with the highest interest rate. Many companies credit payments to a cardholder's lowest-interest-rate balances first, making it more difficult for the consumer to pay off high-rate debt.

In the Senate

Chris Dodd's (D-Conn.) Credit Card Accountability, Responsibility and Disclosure Act

- Prohibits "any time, any reason" interest rate increases and account changes.
- Bans the application of payments so that balances with higher interest rates take longer to pay off.
- Limits fees and penalties.
- Prohibits issuers from using a consumer's card history with another creditor to raise interest rates, a practice known as universal default.
- Ensures that cardholders are informed of the terms of their account.

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SAFE CREDIT CARD STANDARDS

Policy Recommendations for Protecting Credit Cardholders and Promoting a Functional Marketplace

EXECUTIVE SUMMARY

Credit card companies have powers unique in the world of retail lending. After a consumer has agreed to the terms of a credit card account and used the card to make purchases or obtain cash advances, the card issuer may lawfully rewrite the agreement or demand a higher rate of interest, even on funds previously advanced. In a one-year period between 2007 and 2008, issuers used these powers to raise interest rates on nearly one quarter of cardholder accounts. These added charges are not reflected in the advertised annual interest rate, which is the key price point consumers use when choosing credit cards. By rewriting agreements, and by giving themselves broad contractual rights to impose fees and rate increases automatically—practices that the Federal Reserve and other regulators have called “unfair and deceptive”—credit card issuers have rapidly expanded their businesses and billed cardholders tens of billions of dollars more per year.

In 2007, The Pew Charitable Trusts launched an effort, in partnership with the Sandler Foundation, to address growing concerns about abuses in the credit card industry. The project team, led by a former credit card company chief executive officer, researched consumer use of credit cards, conducted economic analyses of credit card practices and revenues, and closely reviewed hundreds of credit card products. In addition to this research and analysis, our team spent more than a year in discussions with over 20 credit card providers and consumer groups, with the goal of identifying balanced approaches to improving the safety of credit cards used by millions of Americans. As part of our research, we looked at all general purpose consumer credit cards offered online by the largest 12 issuers, which control more than 88 percent of outstanding credit card debt in America. As of December, 2008, this assessment covered more than 400 credit cards.

Our survey found that each credit card included one or more practices that qualify as “unfair and deceptive” under recently announced Federal Reserve guidelines. For example:

- 100 percent of cards allowed the issuer to apply payments in a manner which, according to the Federal Reserve, is likely to cause substantial monetary injury to consumers.
- 93 percent of cards allowed the issuer to raise any interest rate at any time by changing the account agreement.
- 87 percent of cards allowed the issuer to impose automatic penalty interest rate increases on all balances, even if the account is not 30 days or more past due. The median allowable penalty interest rate was 27.99 percent per year.
- 72 percent of cards included offers of low promotional rates which issuers could revoke after a single late payment.

The Pew Charitable Trusts will be producing a series of reports in the near future detailing our research and ongoing trends of credit card practices.

Our process of research, analysis and outreach led to several key conclusions, including:

- Current credit card practices place American cardholders at risk of sudden, potentially drastic price increases which can seriously impair a household’s stability and spending power.
- Credit card issuers’ profitability can be sustained with the adoption of transparent and predictable pricing practices.

Nick Bourke

Project Manager

Pew Safe Credit Cards Project

- Strong, universally applicable laws provide the surest means of protecting cardholders and eliminating pressures for issuers to compete through unfair and deceptive practices.

In response, Pew offers a set of Safe Credit Card Standards that are designed to protect cardholders and promote a functional marketplace. The Standards are intended to support policy makers as they evaluate legislative responses to deceptive and dangerous industry practices. Several of the protections identified in our Safe Credit Card Standards are similar to new rules announced by the Federal Reserve and other regulators, but issuers will not be required to adhere to these rules until July

2010. Meanwhile, Pew's research indicates that the overwhelming majority of credit cardholders are vulnerable to unfair and deceptive practices now, which can add hundreds or thousands of dollars per year to the cost of an account.

This report summarizes the research, analysis and outreach which led to the development of the Standards and concludes with a set of recommendations urging immediate passage of the Credit Cardholders' Bill of Rights or similar legislation currently under debate in Congress. In future reports, the Pew Safe Credit Cards Project will provide additional data and analysis to help inform this important discourse.

INTRODUCTION

Most of us would have trouble imagining daily life without the use of credit cards. Yet credit cards can have downsides which are often not apparent to those who carry them. Credit card issuers routinely use their cardholder contracts to reserve the power to impose punitive fees, raise interest rates or change any account term at any time. As a result, the cost of using a credit card can far exceed users' expectations.

In the fast-growing economy of the 1990s and early 2000s, credit card issuers sought ways to expand their businesses. By reserving the power to adjust the terms of credit after an account is opened, card issuers were able to extend more credit to a broad range of customers, including those with minimal or poor credit histories. While some have benefited from these events, many have not. In a one-year period between 2007 and 2008, issuers used their contractual powers to raise interest rates on nearly one quarter of all cardholder accounts, or approximately 70 million accounts.¹ As a result, cardholders incurred at least \$10 billion in additional interest charges on top of standard rates and fees.²

At the same time, Americans also accumulated record levels of credit card debt under increasingly difficult economic circumstances. By the end of 2008, consumer credit card debt exceeded \$900 billion.³ With nearly 1.8 million jobs lost just in the final three months of 2008, credit card delinquencies are on the

rise.⁴ Meanwhile, news reports indicate that a growing number of credit card issuers are raising rates and changing terms, even on accounts in good standing.⁵ When issuers raise rates, individual cardholders will pay hundreds or thousands of dollars per year in additional costs.⁶

In these difficult financial times, strong policy responses are needed to ensure that consumers have access to safe credit based on fair and transparent agreements.

For more than a year, The Pew Charitable Trusts, in partnership with the Sandler Foundation, studied credit card practices and conducted extensive discussions with more than 20 leading credit card providers and consumer advocacy groups. Our independent, nonpartisan research has confirmed that the vast majority of credit cards come with contracts which give issuers nearly unlimited power to raise interest rates, impose significant penalties and fees, process payments in ways which maximize interest charges and otherwise control the terms of credit, regardless of what was stated in previous disclosures. These practices can produce serious consequences, including rapid increases in household debt, unforeseen by most consumers.

Our findings led to the development of the Safe Credit Card Standards, guidelines designed to protect consumers and preserve banks' ability to

manage risk. When implemented, the Standards will help make credit cards safer by ensuring that issuers charge cardholders only the interest rates they agreed to pay, impose fees fairly and transparently, and end certain practices which maximize interest charges to cardholders.

The Safe Credit Card Standards are intended to provide support for policy makers who are evaluating ways to promote safe and economically viable credit cards. Federal regulators recently announced that they will enforce new rules, starting in mid-2010, banning a number of current practices which they deemed “unfair and deceptive.”⁷ These rules, once enforced, will provide several of the protections contained in the Safe Credit Card Standards. But consumers should not be left vulnerable to unfair and

deceptive practices for nearly a year-and-a-half while regulators prepare to enforce their rules. Only Congress can help the tens of millions of Americans who are affected by these practices now. Lawmakers should seize this critical opportunity by enacting the Credit Cardholders’ Bill of Rights or one of the strong alternatives under consideration in the Senate. These bills align closely with the guidelines identified in the Safe Credit Card Standards.

The following pages present the Safe Credit Card Standards as well as an overview of how the Standards were developed and lessons learned. The document concludes with a set of recommendations for lawmakers and companies which provide credit cards to consumers.

DEVELOPMENT OF THE STANDARDS AND CONCLUSIONS DRAWN

In 2007, The Pew Charitable Trusts and the Sandler Foundation launched an effort to address growing concerns about abuses in the credit card industry. The project team, led by a former credit card company chief executive officer and supported by leading industry consultants, researched consumer use of credit cards, conducted economic analyses of credit card practices and revenues, and closely reviewed more than 400 credit cards. Backed by this research and analysis, the team engaged in extensive discussions with over 20 credit card providers and consumer groups, with the goal of identifying balanced approaches to improving the safety of credit cards used by millions of Americans. This process led to the creation of the Safe Credit Card Standards.

The following sections summarize our efforts to develop the Standards.

RESEARCH

To evaluate the need and opportunity for credit card reform, project staff surveyed third-party research and conducted interviews with knowledgeable stakeholders from industry, advocacy, academic and policy backgrounds. This initial inquiry suggested that consumers had little understanding of the costs

and other implications of entering into a credit card agreement. Better disclosures, though helpful, could not fully address this problem, particularly since leading card issuers had claimed the power to change pricing and other terms in those disclosures at any time.⁸ Online surveys and consumer interviews commissioned by the project explored how consumers make decisions when choosing credit cards and probed how deeply consumers understood product attributes such as promotional rate offers, late payment penalties and binding arbitration clauses. This research supported the finding that consumers make decisions largely based on up-front interest rates and rewards disclosures, and tend not to understand the potential for follow-on costs allowed under cardholder contracts.

ANALYSIS OF HOW INDUSTRY PRACTICES AFFECT CARDHOLDERS

We also created several analytical tools to explore the problems and costs cardholders may experience under current industry practices. These tools included a model to estimate actual fee and interest charges based on a cardholder’s balance, payment history and type of credit card. For example, the model can calculate total interest and fees for a given period of time based on scenarios including

the user being a day late on a payment, the user being 30 days past due or exceeding the credit limit, or the issuer changing the contract to raise interest rates on accounts in good standing. The model showed that even cards with similar advertised interest rates can vary in cost by hundreds or thousands of dollars per year depending solely on how an issuer uses its powers to impose penalties or change interest rate agreements.⁹

To determine how widespread these practices are, we reviewed credit card terms of the country's 12 largest issuers, which together hold more than 88 percent of outstanding credit card debt.¹⁰ Researchers gathered available online disclosures for all of the more than 400 Visa®, MasterCard®, American Express® and Discover® branded consumer credit card products offered by these top issuers. This review showed that:

- **All card products surveyed included one or more practices which would violate federal regulators' rules against unfair and deceptive acts or practices.¹¹ These rules will not take effect until July 2010.**
- **100 percent of cards allowed the issuer to apply payments in a manner which, according to the Federal Reserve, "causes or is likely to cause substantial monetary injury to consumers."¹²**

Issuers could apply payments to low-rate balances before paying down high-rate balances. For example, while payments would be applied to reduce promotional rate balances accruing interest at a zero percent annual rate, purchase balances accruing interest at a 15 percent rate would not be reduced. This practice maximizes interest charges to the cardholder.

- **93 percent of cards allowed the issuer to raise any interest rate at any time by changing the account agreement.**
- **87 percent of cards allowed the issuer to impose automatic penalty interest rate increases on all balances, even if the account is less than 30 days past due.**

The median allowable penalty interest rate was 27.99 percent per year, compared to median advertised purchase rates of 9.99 percent to 17.99 percent (issuers advertise a range of interest rates which may apply depending on a consumer's credit profile). This penalty would add charges of between \$100 and \$180 annually for every \$1,000 in revolving purchase debt.

Most cards allowed issuers to impose penalty rate increases indefinitely. Only eight percent of cards with penalty rate conditions offered to restore the original rate terms when payments are made on-time, usually after 12 months.

- **72 percent of cards included offers of low promotional rates which issuers could revoke after a single late payment.**
- **92 percent of cards included a fee for exceeding the credit limit, including 100 percent of all student cards. The amount of the overlimit fee is \$39 on most accounts.**
- **84 percent of cards included binding arbitration agreements, limiting cardholders' legal rights to settle disputes with the issuer in court.**

The above results are based on a survey of credit cards conducted on December 15 and 16, 2008. Our analysis focused on the contractual powers of card issuers based on the written disclosures that issuers are required by law to provide to consumers who apply for a card. Expanded and updated findings will be available in future reports.

ANALYSIS OF HOW REFORMS COULD IMPACT INDUSTRY REVENUE STREAMS

A key objective of our analysis was to identify credit card lending practices which would protect consumers and be viable from a business perspective. Accordingly, we engaged a leading industry consulting firm to develop models which project how eliminating or curbing certain practices, such as raising interest rates as a penalty for exceeding the credit limit, would affect mainstream credit card portfolios. The models dynamically calculated bottom

line revenues based on multiple fee and interest inputs. This approach allowed project staff to engage credit card issuers in numbers-driven discussions about specific practices and proposed reforms.

The portfolio models showed that reforms such as those recommended in the Safe Credit Card Standards would have revenue impacts which could be offset with modest up-front pricing adjustments. For example, prohibiting penalty rate increases except when an account is 30 days past due would represent the most significant revenue impact of the Standards, reducing card portfolio revenues by approximately 4.7 percent. However, this impact would be fully offset by adjusting up-front interest rates by less than one percentage point or applying annual fees in the range of \$15 per year.¹³

STAKEHOLDER OUTREACH.

Outreach to stakeholders formed the core of the project's efforts to develop the Safe Credit Card Standards. Over the course of a year, the project team met frequently with more than 20 credit card providers and consumer groups to identify a set of strong, workable reform proposals. To foster open dialogue, it was agreed that all conversations would be held confidential.

More than 10 credit card issuers, including some of the largest bank and credit union issuers, actively participated in the dialogue. Consumer advocacy groups, including a number of the groups most active in consumer financial services reform, also contributed greatly to the project's efforts. In addition, staff discussed the Standards with several major retail and membership organizations. (These groups sponsor credit cards for their customers and members in conjunction with credit card issuers, an arrangement known as "co-branding.")

During this process, we engaged industry executives to discuss practices which critics had identified as deceptive, and to evaluate a number of proposed alternatives. Using the project's analytical models and information gathered from consumer groups and co-branders, staff identified a number of specific reforms which several issuers agreed were appropriate. Some controversial areas emerged, however, including overlimit fees and penalty rate increases. On these

topics, some issuers supported principles reflected in the Standards (such as eliminating the overlimit fee or ensuring that penalty rates are limited in size and duration), but others did not.

In the course of these discussions we explored creating a program to certify credit cards which meet the Safe Credit Card Standards. Most issuers stated that it would be difficult to commit to the proposed reforms, however, citing a variety of economic or competitive pressures. Project staff found that a key obstacle to voluntary credit card reform is that it would require a market player to take the risk of sacrificing revenue-generating practices while their competitors did not. Almost all of the issuers contacted mentioned this challenge, with the added threat of being undercut by less scrupulous competitors advertising low up-front rates. More than one credit card executive concluded that their company would not significantly change their practices unless government policies made all competitors subject to the same rules.

KEY CONCLUSIONS

Our research and consultation with industry and consumer groups led to the following key conclusions:

- **Credit cards contain hidden dangers which require substantive changes to how these products are designed.**

Though consumers focus on up-front pricing disclosures when making their purchasing decisions, current practices allow numerous and potentially significant follow-on costs which cannot be reflected definitively in these disclosures. Two cards that look identical on the front end can have vastly different costs on the back end.

- **Current credit card practices place American cardholders at risk of sudden, potentially drastic price increases which can seriously impair a household's stability and spending power.**

The vast majority of credit card accounts give issuers broad powers to impose penalties or change interest rate agreements, adding

hundreds or thousands of dollars per year to the cost of the account. These practices are difficult to understand and ultimately impossible to predict; and each year, millions of accounts are negatively affected by them. For many low and moderate income families, the hidden costs of credit cards can significantly reduce the amount of income available for spending and saving.

- **Credit card issuers' profitability can be sustained with the adoption of transparent and predictable pricing practices.**

Revenue impacts of reforms such as those proposed in the Safe Credit Card Standards could be offset with relatively modest up-front pricing adjustments.

- **Strong, universally applicable laws provide the surest means of protecting cardholders and eliminating pressures for issuers to compete through unfair and deceptive practices.**

A number of economically viable options exist for credit card reform. However, revenue expectations and competitive pressures make it difficult for individual companies to discontinue profitable practices, even if those practices can confuse or harm their customers. As long as some companies can use these practices to attract customers with the perception of lower costs, few companies will be motivated to adopt more transparent practices.

GUIDING PRINCIPLES

The Safe Credit Card Standards are guided by the following principles:

- **Simplicity.** Cardholder relationships should be based on simple and easily understood rules.
- **Transparency.** Agreements should clearly indicate the costs, rights and responsibilities of cardholders.
- **Predictability.** The terms of borrowing money should be established beforehand and should not change once the money has been advanced.
- **Responsibility.** Issuers should help cardholders make good decisions, and cardholders should manage their debts carefully.

SAFE CREDIT CARD STANDARDS

A safe credit card will meet or exceed the following standards:

1. **Cardholders will be charged only the interest rates they agreed to pay.**
 - Interest rates for existing balances will not increase, except upon expiration of a temporary promotional rate or changes in a market index such as the Federal Reserve bank prime rate.
 - The interest rate agreement for new charges will not change for at least one year from when the agreement was made.
 - If an account becomes 30 days past due, a temporary penalty interest rate may apply. The penalty will be limited to seven percentage points and the original rate terms will resume after six months of on-time payment by the cardholder.
 - Deferred interest arrangements, which charge interest retroactively for months or years if the balance is not paid in full by a certain date, will not be offered.
2. **Fees will be imposed responsibly and will be transparent to the cardholder.**
 - Other than late payment or returned payment fees, there will be no penalty fees.
 - Other than an annual fee, there will be no account opening/closing or maintenance fees.
 - There will be no overlimit fees. Issuers may decide to allow transactions which exceed the credit limit but will not charge fees for doing so.
 - There will be no fees for making or expediting a payment.
3. **Cardholders will have sufficient time to review and pay their bills.**
 - Periodic billing statements will be sent 21 days or more before the payment due date.
- Applicable grace periods will not expire before the regular payment due date.
- No payment will be considered late if received at the payment center by 5 p.m. local time on the due date, or the next business day if the due date falls on a holiday.
4. **Payments will be applied first to balances carrying the highest interest rate.**
5. **“Double cycle” billing methods, which allow issuers to charge interest on balances the cardholder has already paid, will not be used.**
6. **Cardholders will receive adequate opportunities to evaluate proposals to change the account agreement.**
 - There will be at least 45 days notice before changes in account terms, including price increases and changes in the minimum payment due formula, become effective.
 - Notices will include an opportunity to opt-out of any proposed change by closing the account and repaying it under the unaltered terms.
 - Cardholders will receive access to a complete copy of the updated cardholder agreement.
7. **Account contracts will not limit a cardholder’s legal rights to settle disputes in court. Pre-dispute binding arbitration agreements will not be used.**
8. **Cardholder relationships will be based on simple and easily understood rules. All key information about the account will be provided in short, plain language statements highlighting important information and possible actions to be taken.**

RECOMMENDATIONS

To help make credit cards more safe, fair and transparent, we call for the following actions:

1. **Congress should act now to protect American consumers from practices which federal regulators have identified as “unfair and deceptive.”**

- The Federal Reserve and other regulators recently announced new rules against a number of credit card practices they identified as “unfair and deceptive,” including unfair interest rate increases, payment allocation techniques and balance computation methods. Unfortunately, the regulators will not begin enforcing these rules until mid-2010. In the meantime, American consumers will be vulnerable to billions of dollars in unfair and unpredictable credit card charges. Only Congress can correct this problem by acting now to stop these practices.
- The Credit Cardholders’ Bill of Rights will stop the “unsafe and deceptive” practices identified by regulators quickly rather than leaving consumers unprotected for nearly a year-and-a-half. This legislation will give consumers fast relief while providing banks with ample time to make their practices safe and fair. It includes many of the provisions contained in the Safe Credit Card Standards, including restricting unfair interest rate increases, prohibiting allocation of payments to lowest-rate balances first and ensuring that cardholders do not pay interest on balances they have already paid.

2. **Congress should also act to prevent abuses the regulators will not address, by amending the Credit Cardholders’ Bill of Rights or enacting strong companion legislation currently under evaluation in the Senate.**

- **Prohibit penalty interest rate hikes entirely, or require issuers to limit the size and duration of the penalty.** Issuers today can impose interest rate penalties when accounts become late or for other reasons. The Safe

Credit Card Standards call for limiting penalty rate hikes to seven percentage points and reinstating the originally agreed rates after no more than six months of on-time payments.

- **Require responsible and transparent fee structures.** The Safe Credit Card Standards call for elimination of overlimit fees and other penalty fees other than a late fee; elimination of fees for making or expediting a payment; and combining all maintenance fees into a single annual fee.
- **Require issuers to apply payments to the most expensive balances first.** The Safe Credit Card Standards call for all payments to be applied first to the balance carrying the highest interest rate.
- **Preserve cardholders’ legal rights.** The Safe Credit Card Standards call for the elimination of pre-dispute, binding arbitration agreements which can prevent cardholders from accessing courts to challenge unfair and deceptive practices.

3. **Credit card companies should commit to providing safe, fair and transparent products.**

- Issue cards which meet the Safe Credit Card Standards.
- Comply with new regulatory rules against unfair and deceptive practices now, before the July 1, 2010 enforcement date.

4. **Sponsors of co-branded credit card programs—such as membership organizations, retailers and other businesses—should ensure that the cards they help provide to members and customers are designed to be safe, fair and transparent.**

- Ask Congress to pass strong legislation to protect members and customers from harmful credit card practices.

- Ask the card issuer to meet the Safe Credit Card Standards.
- Ask whether accounts in the program meet the recently announced federal rules against unfair and deceptive acts and practices. If not, ask the issuer to begin complying with the rules immediately.

CONCLUSION

Credit cards have evolved into complex products which can surprise consumers with unexpectedly high costs. Though federal regulators have labeled many common practices in the credit card industry as “unfair and deceptive,” they will not act to stop those practices until the middle of 2010. Meanwhile, millions of American families will pay hundreds or thousands of dollars each in unanticipated fees and charges as a result of these unfair practices.

Only Congress can prevent these burdens from straining household budgets. Our goal in announcing the Safe Credit Card Standards is to help guide and support efforts in Congress to enact prudent credit card reforms which provide urgently needed protection to American consumers.

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Though we developed the Safe Credit Card Standards in close consultation with knowledgeable stakeholders from industry, advocacy, academic and policy backgrounds, Pew has not asked for endorsements from any third party. We may update these Standards from time to time to reflect emerging trends in the credit card industry or new data as it becomes available. For more information on the Safe Credit Cards Project or these Standards, see www.pewtrusts.org/creditcards.

NOTES

- ¹ See: Ireland, Oliver, Letter to the Federal Reserve, et. al. (Morrison & Foerster LLP, August 7, 2008) at Exhibit 6, Tables 1a and 3a (totaling percentage of accounts repriced for penalty or change in terms reasons from March 2007 through February 2008, a total of 22.3 percent of all accounts). Note that these figures may include a number of accounts which entered penalty status or were repriced more than once during the period (this number is not determinable from the data presented). The letter is available at <http://files.ots.treas.gov/comments/bdc5cc5c-1e0b-8562-eb23-ff7159e49505.pdf>. Overall, we estimate that 70 million accounts were affected based on approximately 315 million total active credit card accounts in 2007 (Nilson Report, Issue 902, May 2008).
- ² Actual charges were likely far higher. The repricing events on the affected accounts generated at least \$10 billion in additional interest charges from a sample of accounts representing only 70 percent of outstanding balances. See: Ireland, Oliver (supra footnote 1) at Exhibit 1, Table 1. The table indicates revenues generated when issuers raised interest rates on accounts including at least \$2.7 billion annually due to “change in terms” interest rate increases, and at least \$7.4 billion annually from interest rate increases due to certain types of penalties. The full value of penalty interest rate increases is not provided. See also: Ireland, Oliver at p.1 (sampled data covered approximately 70 percent of outstanding industry balances).
- ³ Author’s estimate based on Federal Reserve G.19 Statistical Release, February 6, 2009 (Total consumer revolving credit was \$963.5 billion in 2008). Credit card debt makes up the vast majority of revolving credit.
- ⁴ See: Bureau of Labor Statistics (<http://www.bls.gov/news.release/empsit.nr0.htm>); See also: Federal Reserve (<http://www.federalreserve.gov/releases/chargeoff/delallsa.htm>).
- ⁵ See, e.g., Chu, Kathy, “Credit Card Reform Gets Another Look; Rising Rates, Fees Anger Lawmakers, Consumers,” USA Today (February 17, 2009). See also: Terris, Harry, “In Cards, A Complex Dance on Rates,” American Banker (March 10, 2009); Berner, Robert, “A Credit Card You Want to Toss,” BusinessWeek.com (February 8, 2008) (Discussing rate increases on Bank of America accounts that were in good standing and held by customers whose credit scores had not declined. When customers complained of experiencing rate increases of 100 percent or more for reasons the bank could not explain to them, some industry analysts concluded that the bank’s move was aimed at shoring up profits); and Kimes, Mina, “Credit Cards’ Carte Blanche,” Fortune (October 13, 2008).
- ⁶ The amount of additional interest can vary widely depending on a cardholder’s balance, the size of the issuer’s rate increase and how long the rate increase applies. For accounts that were repriced between 2007 and 2008, the average rate increase exceeded eight percentage points (Oliver Ireland, supra footnote 1, at p.7). The median balance for all credit card borrowers was \$3,000 (Bucks, Brian K., Arthur B. Kennickell, Traci L. Mach and Kevin B. Moore, “Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances,” Federal Reserve Bulletin, vol. 95, February 12, 2009, at p.A45). An eight percentage point increase on a median balance of \$3,000 would add \$240 per year to the cost of a credit card. For further examples of our analysis, demonstrating how penalty interest rate increases may add hundreds or thousands of dollars a year to a cardholder’s debt, see our comments to the Federal Reserve, dated October 3, 2008. The letter is available at http://www.federalreserve.gov/SECRS/2008/October/20081029/R-1314/R-1314_29314_1.pdf.
- ⁷ The Federal Reserve, Office of Thrift Supervision and National Credit Union Administration jointly published the regulations on Unfair or Deceptive Acts or Practices. See: Federal Register, Volume 74, Number 18 (January 29, 2009).
- ⁸ For a useful overview of the complex credit card pricing structures that have been devised since the early 1990s and the increases in total charges that cardholders are paying, see: “Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers” (GAO 06-929, September 2006). The

GAO reported that “disclosures have serious weaknesses that likely reduced consumers’ ability to understand the costs of using credit cards.” The report called in part for enhanced disclosures to help consumers make better, more informed choices. However, other observers noted that no amount of disclosure could address the risks inherent in the design of credit card contracts. See, e.g. “The Plastic Safety Net, The Reality Behind Debt in America, Findings from a National Household Survey of Credit Card Debt Among Low- and Middle-Income Households” (Demos and the Center for Responsible Lending, 2005). (“Shopping for reasonable terms or comparison shopping for credit cards is almost an exercise in futility, since all credit card issuers now reserve the right to unilaterally change the terms at any time.”)

⁹ For an example of our analysis, demonstrating how penalty interest rate increases may add hundreds or thousands of dollars a year to a cardholder’s debt, see our comments to the Federal Reserve,

dated October 3, 2008. The letter is available at http://www.federalreserve.gov/SECRS/2008/October/20081029/R-1314/R-1314_29314_1.pdf.

¹⁰ The largest 12 issuers include the top-10 Visa / MasterCard issuers, American Express and Discover. (Issuer size is measured by outstanding balances based on data available as of December, 2008.) See: The Nilson Report, Issue 895 (January 2008) and Issue 902 (May 2008).

¹¹ See: Federal Reserve, et. al., supra footnote 7.

¹² Federal Reserve, et. al., supra footnote 7, at p. 5515.

¹³ For an example of our analysis of potential revenue impacts to issuers and possible up-front pricing adjustments, see our comments to the Federal Reserve, dated October 3, 2008. The letter is available at http://www.federalreserve.gov/SECRS/2008/October/20081029/R-1314/R-1314_29314_1.pdf.

-- Protects young consumers from aggressive credit card solicitations.

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Student Loans: Default Rates Are Soaring

As Job Market Tightens, Graduates Are Squeezed; the 'Forbearance' Option

By ANNE MARIE CHAKER

Defaults on student loans are skyrocketing amid a weak job market for graduates and steadily rising tuition costs.

According to new numbers from the U.S. Department of Education, default rates for federally guaranteed student loans are expected to reach 6.9% for fiscal year 2007. That's up from 4.6% two years earlier and would be the highest rate since 1998.

The situation is mirrored in the smaller private student-loan market. In 2008, SLM Corp. also known as Sallie Mae, wrote off 3.4% of its private loans that were already considered troubled, according to its latest annual report -- more than double the figure in 2006. Student Loan Corp., a unit of Citigroup Inc., wrote off 2.3% of those loans in 2008, compared with 1.5% a year earlier.

"The volume of people in trouble is definitely increasing," says Deanne Loonin, a staff attorney at the Boston-based National Consumer Law Center who counsels low-income consumers on student loans and other debt issues.

Lenders say they are hearing more pleas for help as the unemployment rate worsens and debt levels soar among graduates.

Sarah Kostecki, a 24-year-old sales associate in New York, graduated last year from DePaul University with a major in international studies and \$87,000 in debt, translating to monthly payments of \$685, the vast majority of which are private loans.

The payments represent more than a third of her take-home pay, and to help her make ends meet, her grandparents are giving her \$200 a month toward her debt this year. Beginning in January, she'll be on her own, and she worries about falling behind.

"It feels like I'm being punished for having gone to school," Ms. Kostecki says. She has contemplated some of the options offered by private loan companies, such as temporary interest-only payments. But after two years, her payments would jump by almost \$200 a month on top of what she's paying now, she says. "I don't want that."

Borrowers having trouble repaying their federally backed loans can call their lender to request that their payments be put on hold until they get back on their feet. Most types of federal loans qualify for "forbearance" -- meaning the borrower can suspend payments temporarily but is still on the hook for the interest that continues to build while payments are on hold, which is then amortized over the life of the loan.

Certain need-based loans qualify for "deferment," which means the government will cover any interest payments for a

set period. Deferments and forbearances can each be used for a maximum of three years per loan.

There are fewer options for borrowers with private loans, which have soared in recent years as limits on federal borrowing failed to keep up with rising college costs. Students borrowed \$19 billion in private loans in the 2007-2008 school year, six times the amount they borrowed a decade earlier, after factoring in inflation, according to the College Board, a New York-based nonprofit.

In the past, it was relatively easy to get a forbearance on a private loan, says Ms. Loonin. The lenders "gave these loans to a lot of people that couldn't afford them," she says. "To mask the problem, they kept giving forbearances." But as more borrowers are running into trouble, lenders are becoming stricter, she says.

Some major lenders, such as First Marblehead Corp. and [J.P. Morgan Chase & Co.](#), declined to say how many forbearances they've been granting. Others, including Wells Fargo & Co. and the nonprofit Vermont Student Assistance Corp., said they are granting more lately.

For private borrowers, finding what assistance programs are available is often a chore; information on Web sites can be sparse and hard to find. Here's how some private lenders are working with students who are having trouble paying back their loans:

Sallie Mae. The lending giant, which makes both federally backed and private loans, says it grants private borrowers forbearances in increments of up to three months, and may be extended several times, typically up to a total of 24 months. There's a forbearance fee of \$50 per loan, up to a maximum of \$150. Another option may be to extend the repayment period by several years, which in turn lessens monthly payments, though the minimum balance must be at least \$20,000.

Key Corp. Key says it grants forbearances in six-month increments, with conditions depending on individual circumstances. For instance, someone struggling with a job loss may have greater need than someone else whose pay was cut. While some borrowers may qualify for a full forbearance, others may qualify only for reduced payments. Either way, Key says it doesn't charge any additional fees.

Student Loan Corp. Borrowers in trouble can make interest-only payments for a period of either two or four years. They might also qualify for a forbearance, generally up to a maximum of 12 months. There are no fees for either option.

Wells Fargo. Borrowers can apply for forbearance, granted "generally in cases of extreme financial hardship," a spokeswoman says. There are no fees, and length of time is based on individual circumstances.

Write to Anne Marie Chaker at anne-marie.chaker@wsj.com

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N. J. Assembly Advances Bill Limiting Credit Card Marketing on Campuses

The Consumer Affairs Committee of New Jersey's General Assembly approved a bill that would restrict credit card issuers' marketing efforts on all of the state's college campuses.

The bill, which assemblywomen Sandi Love and Pamela R. Lampitt introduced in June, would prohibit issuers from buying or renting students' names, addresses or contact information for marketing purposes and would prohibit using gifts or other promotional incentives to lure students to apply for cards.

The law would require any issuers marketing to students to provide an educational course on responsible credit card use and give full explanations of card terms and how issuers compute interest. The proposed legislation also would require students to certify they have completed the course before applying for a credit card.

According to the authors of the bill, many New Jersey college students find themselves overwhelmed by crippling debt owed on cards they applied for because issuers were soliciting on campus.

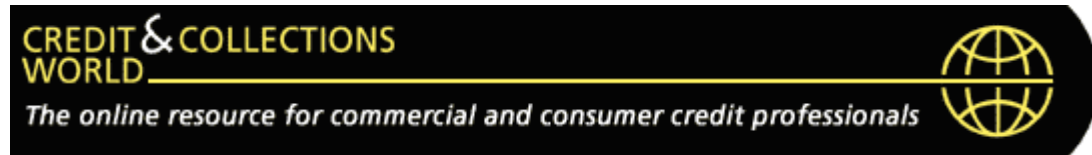
The bill is now cleared to move to the House floor for a vote. An identical bill, also introduced in June in the Senate, was referred to the Senate Commerce Committee, which reconvenes next month.

In recent years 18 states, including California and Texas, passed laws restricting credit card marketing on college campuses.

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Debit Cards? Gift Cards? Payroll Cards?

Get answers on the fast-paced prepaid card and stored value market.

Illinois Treasurer Seeks To Curb Card Marketing On College Campuses

Illinois is joining a growing number of states seeking to curb credit card issuer gift giveaways on college campuses. In recent years, 18 states have passed laws restricting credit card marketing on college campuses.

Earlier this month, State Treasurer Alexi Giannoulias drafted legislation that would crack down on gifts issuers give students for signing up for a credit card and restrict access to student information that card marketers can use to target students directly by mail, phone or e-mail.

The legislation would ban issuers from offering gifts when marketing credit cards on campuses; prohibit colleges, universities, foundations and alumni associations from selling or transferring student names and personal information to card issuers; require those institutions to disclose marketing agreements with banks that target students; and force schools that allow credit card marketing or advertising to provide courses to freshmen on financial literacy.

Giannoulias will introduce the bill to the General Assembly in January, according to a spokesperson.

"As college students head back to school, they're bombarded by credit card companies offering freebies if they sign up for a card. This is a troubling trend that can have tragic results as debt piles up," Giannoulias said in a statement.

"These aggressive, and in some cases predatory, practices are often aimed at students who have never had any serious financial obligations," he said. "It creates a perfect storm when you consider many students don't have a steady source of income and are more concerned with current costs than dealing with their long-term debt."

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PERSONAL AUTO PAID CLAIM COST AND FREQUENCY*

*From FAST Track ExpenseTM
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All comparisons of year-ended paid claim cost and frequency data refer to changes from third-quarter 2008 to fourth-quarter 2008.

For Personal Auto Liability Bodily Injury, the year-ended paid claim frequency fell 1%, and the year-ended average loss rose almost 2%. The year-ended pure premium increased nearly 1%.

For Personal Auto Liability Property Damage, the year-ended paid claim frequency dropped 2%, and the year-ended average loss rose nearly 1%. The year-ended pure premium fell 1%.

For Personal Injury Protection, the year-ended paid claim frequency decreased 2%, and the year-ended average loss rose more than 1%. The year-ended pure premium fell almost 1%.

The year-ended average loss for Collision increased slightly. The year-ended paid claim frequency fell more than 1%, and the year-ended pure premium dropped 1%.

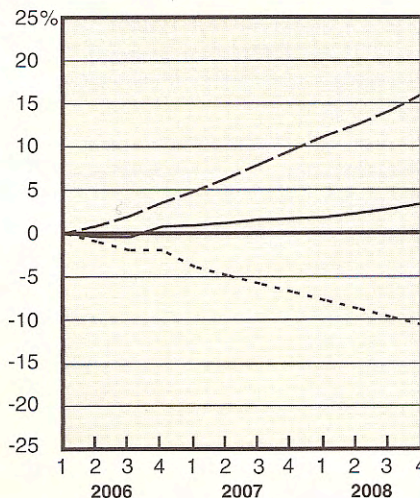
The year-ended paid claim frequency for Comprehensive declined 1%. The year-ended average loss rose almost 3%, and the year-ended pure premium grew 2%.

* Graphs depict relative change from year-ended first-quarter 2006:

Claim Frequency - - - - Average Loss - - - - Pure Premium - - - -

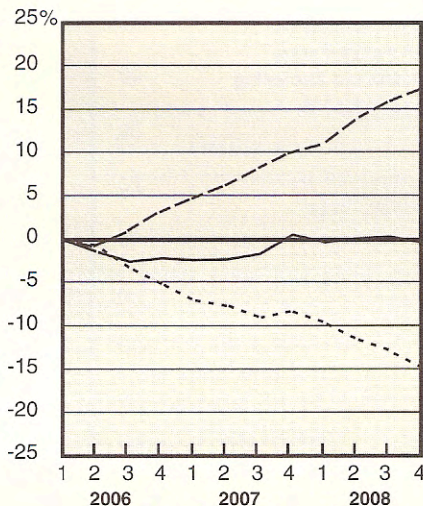
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Relative Change



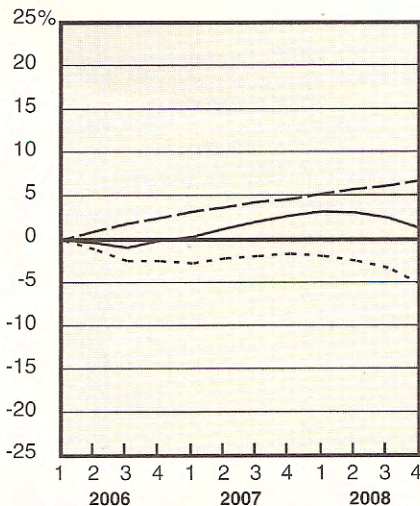
Liability — Personal Injury Protection

Relative Change



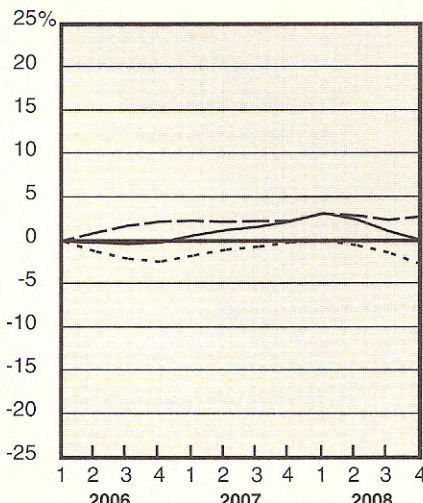
Liability — Property Damage Total Limits

Relative Change



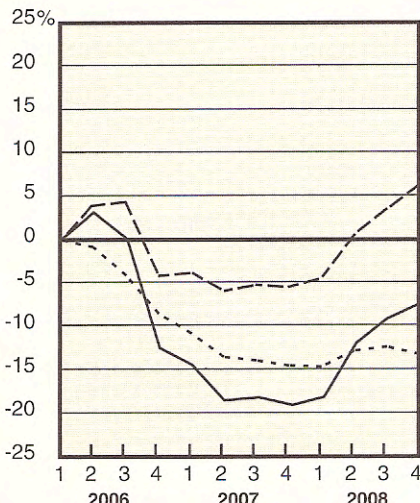
Physical Damage — All Collision Combined

Relative Change



Physical Damage — All Comprehensive Combined

Relative Change



**CREDIT SCORING AND INSURANCE:
COSTING CONSUMERS BILLIONS AND
PERPETUATING THE ECONOMIC RACIAL
DIVIDE**



June 2007

**Credit Scoring and Insurance:
Costing Consumers Billions and
Perpetuating the Economic
Racial Divide**

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National Consumer Law Center
Center for Economic Justice

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EXECUTIVE SUMMARY

The use of credit scores in home and auto insurance is a poorly understood phenomenon with a huge economic impact on Americans. It's also a practice that creates wide racial disparities. This report presents an overview of credit scores, which are three digit numbers designed to predict risk based on a consumer's credit record. The report also summarizes the multitude of studies showing the discriminatory impact of credit scoring. It analyzes these racial disparities in light of recent research about the enormous racial wealth divide and its historical origins.

Key findings of this report are:

- Consumers know little about the use of credit scoring and credit records in granting or pricing insurance - only 36% know that a credit history can affect insurance coverage or premiums. When they do find out, they overwhelmingly disapprove of the practice.
- Some of the factors used in insurance scoring models are questionable, such as penalizing consumers with fewer than 2 credit card accounts or those who have installment loans (such as auto loans). Credit scoring in general has been criticized on a number of bases, such as the high rate of errors in credit reports and inconsistent data between the major credit bureaus.
- Much of the insurance industry relies on credit scoring because it is allegedly predictive in forecasting which consumers will have higher loss ratios. Yet the industry has not offered a satisfactory explanation as to *why* there is a correlation between credit scores and loss ratios.
- The use of credit scoring is tied to a significant increase in profits for insurers, whose loss ratios have decreased substantially. Credit scoring may have benefited insurers (and thus cost consumers) somewhere in the neighborhood of \$67 billion from 2003 to 2006.
- Study after study has documented the fact that credit scores disfavor minority consumers. Since 1994, at least 5 studies of traditional credit scores (for credit granting purposes) have shown that African Americans and Latinos have lower scores as a group. At least two studies by state insurance bureaus have found that African Americans and Latinos are overrepresented among consumers with low credit scores and under-represented among those with high credit scores. Furthermore, minority consumers are more likely to lack the credit history necessary to even generate a credit score.
- Anti-discrimination laws present limited avenues to challenge the racial disparities created by credit scoring. There are some viable theories to challenge insurance scoring in home insurance, but fewer challenges available in auto insurance.

Finally, we argue that racial disparities in credit scoring are a product of historical economic discrimination against minorities. Government policies that economically boosted whites while leaving minorities behind are responsible for the racial wealth gap. Credit scores act as both a numerical reflection of that gap as well as a force widening the gap. We echo the call of many advocates to ban the use of insurance scoring in order to stop the perpetuation of economic discrimination. If states do continue to permit their use, insurers must be required to develop scoring systems that do not have a disparate impact on minority populations.

I. INTRODUCTION

It is no secret that a huge wealth gap exists in this country, and it is divided along color lines. African Americans earn only 62 cents for every dollar earned by whites, and Latinos earn only 70 cents.¹ Even more disturbing is the divide in assets. African American families own less than seven cents for every dollar in wealth owned by white families, while Latino households own less than nine cents for every dollar of white wealth.² These huge disparities in income and wealth are due to a historical legacy of racism, redlining and segregation.³ Unfortunately, the racial wealth gap is not closing.⁴ Indeed, the policies and practices of both the government and the business sector have widened that gap in the last decade.

One of the practices that has reinforced and exacerbated the racial wealth gap is credit scoring. Study after study has shown credit scoring disfavors African Americans and Latinos, and that these communities have lower credit scores as a group. Credit scoring's disparate impact is alarming because this solitary number is being used in a growing number of economic transactions - not just granting of credit, but utility service, apartment rentals and even employment decisions. Credit scores are also being used to decide whether to issue home or auto insurance and at what cost, which is the focus of this report.

The difficult issue is that while credit scoring has a disparate impact, it has been shown to be predictive in the credit context. In the insurance context, companies claim that it is also predictive in forecasting which consumers will have higher loss ratios. Thus, credit scoring may be a useful tool for businesses, but one that discriminates. The issue for our society is whether we permit the use of this tool knowing that it not only hurts minorities, but also that the disparate impact of this tool reflects centuries of discrimination, exclusion, and exploitation of minority groups.

A. *What is Credit Scoring?*

A credit score is a number generated by a computer program based on information from a credit history as recorded by a credit bureau such as Experian, Equifax, and Transunion (the 'Big Three' credit bureaus). A credit history contains information about a consumer's credit experiences, including bill-paying histories, the number and types of accounts she has, whether she has had bills sent to debt collection agencies, her outstanding debt amounts, and the age of her accounts. A credit score supposedly helps predict how creditworthy a consumer is. That is, how likely it is that the consumer will repay a loan and make the payments when due.

¹ Carmen DeNavas-Walt, Bernadette D. Proctor, and Cheryl Hill Lee, *Current Population Reports, P60-229, Income, Poverty, and Health Insurance Coverage in the United States: 2004*, U.S. Census Bureau (August 2005).

² Rakesh Kochhar, *The Wealth of Hispanic Households: 1996 to 2002*, Pew Hispanic Center (October 2004)

³ These disparities often lead unscrupulous sellers to target minority consumers for higher priced credit, not because of overt bias, but stemming from a perception that these consumers are more vulnerable to "sucker pricing." See Ian Ayres, *Pervasive Prejudice?: Unconventional Evidence of Race and Gender Discrimination* (2001); Jan Pillai & M. Tulloss, *Racial and Gender Discrimination at the Cash Counter*, Miss. State J. Int'l L. 507 (2003) (book review). These disparities sometimes become internalized as well, creating a self-perception by some minority borrowers that they do not qualify for affordable credit and their only option is expensive subprime credit. See generally David Dante Trott, *Ghettos Revisited: Antismarkets, Consumption, and Empowerment*, 66 Brook. L. Rev. 1 (2000).

⁴ According to the Pew report, since 1996 the median net worth of black families in the United States has fallen by 16.1 percent. For white families, net worth grew by more than 17 percent. Rakesh Kochhar, *The Wealth of Hispanic Households: 1996 to 2002*, Pew Hispanic Center (October 2004).

The most popular type of credit score is generated by Fair Isaac & Co and is often called a ‘FICO score’. It generally ranges between 300 and 850, and is primarily used in the credit context. A higher number is considered a better score. There are many other types of credit scores in addition to FICO scores, some of which are generated using information in addition to a credit history, such as data obtained from a credit application or other sources. The insurance industry uses its own specialized scoring models, discussed in Section II.

According to Fair Isaac, its credit scoring models generally evaluate the following types of information:

- Payment history (35%)
- Amount of credit utilized (30%)
- Length of credit history (15%)
- Recent applications for credit (10%)
- Number and types of credit accounts (10%).

B. Uses of Credit Scoring

Credit scoring has become an increasingly dominant factor in our economic lives. Credit scores dictate whether a person will be able to buy (and keep) a home by obtaining a reasonable mortgage. They also determine how expensive it will be to buy a car, a critical tool for many Americans to get to work. They determine access to other kinds of credit, such as credit cards, as well.

Credit scores, however, are being used far beyond simple credit decisions. Employers use credit scores when evaluating applicants, even for jobs that do not involve handling money.⁵ Many utilities use credit scores to determine whether to turn on the lights or the heat without requiring a security deposit.⁶ One utility even proposed using it to set the price of electricity for its customers.⁷ Landlords use credit scores to decide whether or not to rent an apartment.

Credit scores have become as important a number, if not more so, than a person’s salary or grade point average. A bad credit score is a financial “Scarlet Letter” ostracizing a person from the land of reasonably priced credit, good jobs and (as discussed in this paper) insurance coverage.

⁵ John Cook, *Credit Follows Us Everywhere*, Contra Costa Times, May 19, 2003, at 4.

⁶ National Consumer Law Center, *Access to Utility Service*, § 3.7.4.7 (3rd. ed. 2004).

⁷ Sudeep Reddy, *Utilities Spark Data Debate: Customer Payment Histories May Be Used To Set Rates Under New Law*, Dallas Morning News, June 30, 2005.

II. INSURANCE SCORING

Over the last decade a growing number of auto and home insurers have been using credit scores to determine whether to insure a consumer and at what price. An early survey found that 92 percent of auto insurers surveyed use credit scores.⁸ As a result, a consumer with a poor credit history may be charged anywhere from 40% to several hundred percent more in premiums for automobile insurance.⁹ A number of major home insurers use credit scores as well, including Allstate,¹⁰ Nationwide Mutual¹¹ and Hartford Financial Services Group.¹²

A. Criticisms of Insurance Scoring

Insurance companies justify their use of credit scores by citing several studies that have found a high correlation between credit scores and loss experience. For example, a June 2003 study commissioned by the insurance industry found that individuals with the lowest insurance scores incurred 33% higher losses than average, while the highest scorers incurred 19% lower losses.¹³

The primary criticism of this justification has been simple - there is no explanation for *why* a person with a lower credit score is more likely to cause higher loss to insurers. While there may be a correlation, there does not appear to be an easily identified and logical causal link between a consumer's credit history and whether she will have an auto accident or accident with her home. Even the industry admits they don't understand the link, with a trade association spokesperson noting "it's not the most intuitive connection, the way it is for making a mortgage."¹⁴ The reason for the correlation might be caused by a factor that is not the fault of the consumer, or a factor that we as a society would want to ban as a justification for provision of service- such as race or income.

Insurers sometimes put forth a "moral person" hypothesis to explain the link between credit scoring and loss history, *i.e.*, they argue that a person who is reckless with credit may also be reckless with driving or irresponsible about maintaining a home.¹⁵ This ignores the fact that many people end up in a financial crisis (thus lowering their credit score) due to illness, job loss or divorce.¹⁶

⁸ Brian Grow and Pallavi Gogoi, *Insurance: A New Way to Squeeze the Weak?* Business Week, January 28, 2002, at 92 (citing study by Conning & Co.).

⁹ Pamela Yip, *One Number, Many Uses*, Dallas Morning News, April 8, 2002, at 1D; Kathy Chu, *Getting Personal: Poor Credit Can Drive Insurance Rates Higher*, Dow Jones Newswires, May 21, 2003.

¹⁰ DeHoyos v. Allstate Corp., 345 F.3d 290 (5th Cir. 2003).

¹¹ Owens v. Nationwide Mutual Insurance Co., 2005 WL 1837959 (N.D. Tex. Aug. 2, 2005).

¹² Reynolds v. Hartford Financial Services Group, 435 F.3d 1081 (9th Cir. 2006), *rev'd sub nom.*, Safeco Ins. Co. v. Burr, -- S. Ct. ---, 2007 WL 1582951 (June 4, 2007).

¹³ Michael J. Miller and Richard A. Smith, *The Relationship of Credit-Based Insurance Scores to Private Passenger Automobile Insurance Loss Propensity*, EPIC Actuaries (June 2003).

¹⁴ Jonathan Epstein, *Outraged by 'Credit Scoring'? Auto, Home Insurers Use a Person's Credit History to Set Rates*, Buffalo News, November 28, 2004 (quoting spokesperson for the Property Casualty Insurers Association).

¹⁵ See, e.g., Insurance Information Institute, *FAQs*, at <http://www.insurancescoring.info/faq.htm> (last viewed June 2007) ("people who manage their money well tend to manage their most important financial asset - their home - just as well. People who handle money responsibly also tend to handle their driving responsibly").

¹⁶ See, e.g., David U. Himmelstein, Elizabeth Warren, Deborah Thorne, and Steffie Woolhandler, *Illness and Injury as Contributors to Bankruptcy*, Health Affairs – Web Exclusive, February 2, 2005, available at <http://content.healthaffairs.org/cgi/reprint/hlthaff.w5.63v1> (finding that half of all bankruptcies are caused in part by medical reasons, such as illness or injury, medical debt, or lost work due to medical reasons).

Consumer advocates believe that an alternative explanation for the correlation, if one truly exists, is simply wealth. There is a correlation between insurance scores and income (discussed below in Section IV.B). Consumers with lower incomes and lower scores simply may have fewer financial resources, and thus be more likely to file a claim rather than “eating” the loss.¹⁷ For example, a Texas study found that while credit scores were related to loss experience, the correlation was due to a higher frequency of claims for low scorers, not a greater dollar amount per claim.¹⁸ This suggests that to the extent there is a correlation, it is because low scoring consumers are more likely to file claims, not because they actually sustain greater losses.

Finally, there is some question as to whether this correlation between credit scores and insurance loss ratios actually exists and how robust it is. While industry studies claim there is a correlation, the underlying data behind these studies has never been provided so that the results can be independently verified.

For further resources on the problems with insurance scoring, readers should consult the Center for Economic Justice’s website at www.cej-online.org/creditscoringmainpage.htm.

B. Consumer Awareness of Insurance Scoring

Most consumers are not aware that credit scores can have an impact on their ability to obtain insurance or the price they will pay for it. A telephone survey conducted by the Government Accountability Office of 1578 consumers found that only 36% of them knew that a credit history can impact their insurance coverage or premiums. More consumers (42%) actually believed the opposite, *i.e.*, that credit history does not affect insurance, and 22% of consumers responded that they did not know.¹⁹

Consumers also expressed their belief that the use of credit scoring in insurance is unfair. A Scripps Howard telephone poll conducted in Texas found that 68% of respondents favored a ban on the use of credit history for insurance underwriting and pricing.²⁰

C. Elements of an Insurance Score

The credit scores used by insurers, or “insurance scores,” are specially developed for insurance purposes and not the same as generic FICO scores for credit granting. Insurance scores are generated using a different scoring model (or computer program) than for generic credit scores. Insurance scoring programs use different factors, and give those factors a different weighting than for generic credit scores. What they do share in common with FICO-type scores is a reliance solely on credit history.

In Texas, a consumer advocacy group was able to get a glimpse into the black box of insurance scoring. Texas Watch analyzed some of the scoring models used for home and auto insurance in

¹⁷ Carrie Teegardin, *Insurance Injustice? When Credit Matters*, Atlanta Journal-Constitution, December 10, 2006.

¹⁸ Texas Department of Insurance, *Report to the 79th Legislature - Use of Credit Information by Insurers in Texas*, December 30, 2004.

¹⁹ Government Accountability Office, *Credit Reporting Literacy: Consumers Understood the Basics but Could Benefit from Targeted Educational Efforts*, GAO-05-223, March 2005.

²⁰ *The Scripps Howard Texas Poll*, Spring 2003, results on file with author.

that state and found some interesting scoring criteria. Some of the examples being used in various insurance scoring systems included:²¹

- Average number of months all accounts on file have been open.
- Number of accounts opened in the last year. Consumers were penalized for opening more than 1 or 2 new accounts in a year.
- Age of oldest account in months. Consumers lost points for not having accounts that were over several years old. In addition to penalizing young consumers, it presents risks to a homeowner who pays off her 30 year mortgage, which may be her oldest account.
- Number of consumer-initiated credit inquiries in last 2 years. Insurance scores suffer after more than 2 inquiries.²² Inquiries happen, not just when a consumer shops for credit, but if she switches cell phone service, rents an apartment, or opens a utility account (electric, heat, and even cable service). So consumers' insurance scores take big hits when they move.
- Number of credit card accounts open. Consumers with fewer than 2 credit cards are penalized.
- Number of credit card accounts where balance is 75% or greater than limit.
- Number of months since last account activity. Consumers lose points for not having any activity in the last month. So consumers are penalized, for example, if they have a credit card but don't use it.
- Number of installment loan accounts (car loans for example). Ironically, having a car loan costs points on an insurance score.
- Number of accounts in good standing *with a balance*. Not having a balance on an account can hurt a consumer. Once again, a consumer with a credit card is penalized for not using it. One would think paying off an account should be considered favorable.
- Number of open retail store or sale finance accounts. Having even one store card (e.g., Sears, Best Buy or Home Depot) will result in a lower insurance score.
- Number of open automotive related accounts. Consumers with car loans face a double whammy. They lose points for having an installment loan and having an auto-related loan.
- Number of open oil company accounts. Consumers get points for having a gas company credit card.
- Number of public records (includes bankruptcies, liens, collections, etc.).

²¹ Texas Watch, *Sample Credit Scoring Model, Consumer Insurance Tips - Credit Scoring* (undated).

²² For credit granting purposes, FICO scores count multiple inquiries for home and auto loans with a certain time period, such as 14 days, as a single inquiry.

- Longest delinquency on an account.

Some of these factors, such as having too few credit cards, are questionable at best.

In Georgia, an analysis by the Atlanta Journal-Constitution of insurance scoring models in that state found similar factors being used, such as:²³

- Some models reward customers with Visa or MasterCard credit cards over those with department store cards.
- Spreading debt over three credit cards can result in a better score than consolidating the same amount of debt onto one card.
- Too many credit cards would lower the score, but so would too few.
- Various insurance companies will score the same person in a completely different way.

Furthermore, the questions raised by some of the dubious criteria used in insurance scoring are in addition to problems presented by traditional credit scores. There have been a number of criticisms of credit scoring in general, including:

- Credit reports are notorious for containing errors. In one study, 79% of consumers reviewing their own credit reports found mistakes in the reports, and 25% of them contained mistakes that were serious enough to result in the denial of credit.²⁴ Another study estimated that at least one in five borrowers are likely being penalized because of an inaccurate credit score due to credit reporting problems.²⁵
- Credit scores are inconsistent depending on which credit bureau's data is being used. An examination of over 500,000 consumer credit files found that 29 percent of consumers have credit scores that differ by at least 50 points between credit bureaus, while 4 percent have scores that differ by at least 100 points.²⁶ A difference of 50 points in a credit score could mean the difference in a mortgage, for example, between 6.522% APR (for a score of 670) versus 7.332% APR (for a score of 620), which is a difference of \$108 per month on a \$200,000 30-year fixed mortgage.²⁷
- Credit scores penalize young consumers by favoring "old" credit.
- Credit scores allow creditors to artificially manipulate their customers credit scores by, for example, not reporting credit limits. Since one of the factors in a scoring model is the

²³ Carrie Teegardin, *Insurance Injustice? When Credit Matters*, Atlanta Journal-Constitution, December 10, 2006.

²⁴ Alison Cassidy and Edmund Mierzwinski, *Mistakes Do Happen: A Look at Errors in Consumer Credit Reports*, MASSPIRG Educational Fund (June 2004).

²⁵ Consumer Federation of America and National Credit Reporting Association, *Credit Score Accuracy and Implications for Consumers*, December 17, 2002.

²⁶ *Id.*

²⁷ Rate quotes from the www.myfico.com website as of June 5, 2007.

ratio of credit used to credit available, failing to report a credit limit will depress a credit score by making it seem that a consumer is “maxed out.”²⁸

D. Examples Of Consumers Hurt By Insurance Scoring

The use of credit scoring in insurance has had a personal impact on many Americans. Here are some case studies of consumers who have seen their insurance rates skyrocket due to credit scoring:

Jose DeHoyos, a 65-year-old Hispanic-American from Somerset, Texas, saw his rates go up 25% with the use of credit scoring. DeHoyos had been a customer of Allstate for 26 years when the giant insurer raised his rates. During those 26 years, DeHoyos had filed only one claim --for hailstorm damage to his car five years ago. To add insult to injury, DeHoyos had only minor blemishes on his credit history -- two late payments totaling \$131 to a hospital and a gas station.²⁹

Kathryn Perry fell behind in paying bills when her daughter died, but got back on track six months later. The black marks on her record from that six month period, however, cost her dearly. Her auto insurer refused to renew her policy at the \$435 a year she had been paying. Instead, she was offered a high risk policy costing a whopping \$6,000 per year.³⁰

James White, a 60 year old assistant school superintendent, saw his rate rise by 60% for his homeowner’s insurance. His problem was that too many lenders had pulled his credit report. While some of the inquiries occurred when he went shopping for a mortgage, car, and other credit, more than half of the two dozen inquiries came unsolicited from business looking to sell him something.³¹

One group that is particularly vulnerable to insurance scoring is elders, because many of them have paid off their mortgages and do not use other types of credit. They may not have insurance scores or have low scores due to only a few accounts. For example:

Pat and Clyde Henry are a retired couple in their 60s from Akron, Ohio. They paid off their mortgage years ago, paid cash for their cars, and have no credit cards. As a result, they have no credit record and no insurance score. One would assume the Henrys are a good risk given their responsible financial behavior and lack of debt. But because they did not have a credit score, they were instead penalized. Their homeowner’s insurance premiums doubled, from \$286 per year to \$596 per year.³²

The Henrys were not alone in being punished for not having or using credit cards:

Mattie Grainger, a senior citizen in South Carolina, had used the same insurance company for 34 years. This company increased her auto insurance premium by \$100

²⁸ Evan Hendricks, *Credit Scores & Credit Reports: How the System Really Works, What You Can Do*, Privacy Times (2d ed. 2005), Ch. 22.

²⁹ Mr. DeHoyos is the lead plaintiff in the case, *DeHoyos v. Allstate Corp.*, 345 F.3d 290 (5th Cir. 2003).

³⁰ Kathy Chu, *Getting Personal: Poor Credit Can Drive Insure Rates Higher*, Dow Jones Newswires, May 21, 2003.

³¹ Kathy Chu, *Getting Personal: Credit May Affect Your Insurance Rates*, Dow Jones Newswires, July 7, 2004.

³² Betty Lin-Fisher, *Couple Penalized for Having No Debt*, Beacon Journal, February 29, 2004.

because her score was not considered top tier. Ms. Grainger's problem: she only had a few accounts and rarely used the two credit cards she owned. Her relatively debt-free life cost her points on her insurance score.³³

Donald Tonack, who himself is a former insurance underwriter, was hit with an 11% increase in his auto insurance because of his insurance score. The 65 year old Oregon man had used the same insurance company for 17 years and had a clean driving record for 40 years. Despite this, Mr. Tonack saw his insurance rates rise because he didn't have a revolving credit account (*i.e.*, a credit card account).³⁴

Finally, insurance scoring penalizes consumers who have been the victim of identity theft, the fastest growing crime in this country:

Ted Jordan, a Georgia resident, was victimized by an identity thief who took out \$18,000 in student loans in Jordan's name to attend a car repair trade school in California. Jordan was forced to file a lawsuit to clean up his credit record. In the meantime, Jordan saw his homeowner's insurance rate from Allstate spike due to the black marks on his credit record.³⁵

III. INSURANCE CREDIT SCORING MAY BE LINKED TO BILLIONS IN INCREASED PROFITABILITY TO INSURERS

When appearing before legislatures and regulators, insurers argue that insurance scoring allows them to more accurately price risks and is "revenue neutral." By "revenue neutral," insurers mean that insurance scoring raises the rates for some consumers and lowers the rates for others, but does not change the overall premium level. Insurers argue that insurance scoring simply enables them to better assign premiums to consumers based on the risk posed by those consumers.

In fact, insurers' use of credit scoring – the introduction of many, many rate levels based predominantly on the insurance score – may have contributed to a dramatic increase in insurance profitability. Table A shows loss ratios for private passenger auto liability insurance from 1999 through 2005. The loss ratio is the ratio of losses to premium³⁶ and shows what portion of the premium dollar is returned to consumers in claim payments. The table shows that loss ratios declined dramatically over the period – the same period in which insurers' use of credit scoring became more widespread and became more influential on rates charged. An explanation for the sources and calculation of the data is set forth in Appendix A of this report.

The data shown in Table A are inconsistent with insurers' claims about "revenue neutrality." If credit scoring was, in fact, revenue neutral, we would expect loss ratios to remain relatively constant over the period. The fact that loss ratios dropped dramatically indicates that premium growth far exceeded growth in losses and that insurers used credit scoring to raise rates for certain groups of

³³ Elaine Gaston, *Bills Would Unlink Credit, Insurance*, Myrtle Beach Sun News, February 23, 2002.

³⁴ Kathy Chu, *Getting Personal: Credit May Affect Your Insurance Rates*, Dow Jones Newswires, July 7, 2004; Ellyn Ferguson, *Legal Battle Brewing Over Release of Credit Score*, Chicago Sun-Times, November 7, 2003.

³⁵ Carrie Teegardin, *Insurance Injustice? When Credit Matters*, Atlanta Journal-Constitution, December 10, 2006.

³⁶ The loss ratios presented are, more precisely, incurred losses to earned premiums. See Appendix A for a description of data, data sources and calculations.

consumers without commensurate reductions for other consumers and failed to lower rates to reflect lower claim costs.

Insurers would argue that the initial years in the period cited were unprofitable and that recent loss ratios are simply a return to profitability. Table A and Appendix A refute this claim by showing that rates and premiums have been, in recent years, significantly in excess of levels commensurate with a reasonable profit.³⁷ Premiums were excessive by about 8%, 14%, 11% and 14% in 2003, 2004, 2005 and 2006 respectively, for a total overcharge of \$67 billion during the four-year period.

When insurers pitch their company's stock to investment analysts, they tell a different story about credit scoring – they admit that credit scoring has increased insurer profitability. Consider the presentation by Ed Liddy, then CEO of Allstate, to investment analysts in 2005, in which he stated:

Tiered pricing helps us attract higher lifetime value customers who buy more products and stay with us for a longer period of time. That's Nirvana for an insurance company. That drives growth on both the top and bottom line.

This year, we've expanded from 7 basic price levels to 384 potential price levels in our auto business.

Tiered pricing has several very good, very positive effects on our business. It enables us to attract really high quality customers to our book of business.

Make no mistake about it, the economics of insurance are driven largely by retention levels. It is a huge advantage. And our retentions are as high as they have ever been.

The key, of course, is if 23% or 20% of the American public shops, some will shop every six months in order to save a buck on a six-month auto policy. That's not exactly the kind of customer that we want. So, the key is to use our drawing mechanisms and our tiered pricing to find out of that 20% or 23%, to find those that are unhappy with their current carrier, are likely to stay with us longer, likely to buy multiple products and that's where tiered pricing and a good advertising campaign comes in.

It [tiered pricing] has raised the profitability of the industry.³⁸

³⁷ Using the reasonable profit provision as determined by the Texas Commissioner of Insurance, discussed in Appendix A. The Texas Commissioner established a profit provision for private passenger auto which can be applied generally, not just for use in Texas. It was the outcome of a contested case hearing in which several parties put forth their proposed profit provisions and the Commissioner decided and explained in detail in his rate order why the specific provision was adopted.

³⁸ Partial Transcript of Presentation to Edward M. Liddy, Chairman and CEO, The Allstate Corporation Twenty-First Annual Strategic Decisions Conference, Sanford C. Bernstein & Co., June 2, 2005.

Table A: Private Passenger Automobile Insurance, Loss Ratios and Excessive Premium

	1999	2000	2001	2002	2003	2004	2005	2006
Loss Ratio	65.9%	71.3%	72.7%	67.5%	62.8%	58.6%	60.1%	57.9%
% Excessive (\$ billions)	3.5%	-2.7%	-4.1%	1.8%	7.8%	14.0%	10.8%	14.5%
\$ Excessive (\$ (billions))	4.0	(3.3)	(5.6)	2.5	11.1	19.6	15.7	20.5

As with personal auto insurance, credit scoring may have increased insurers' profitability for homeowners insurance. Although homeowners results for insurers are affected by catastrophic events, such as Hurricane Katrina, the table below shows that insurers' payouts for homeowners claims did not exceed premiums on a nationwide basis even in 2005 when insurers experienced the worst catastrophe losses – by far – of any year.

Table B: Nationwide Loss Ratios for Homeowners Insurance

Year	Ratio
1999	63.7%
2000	66.4%
2001	77.2%
2002	65.9%
2003	59.2%
2004	66.0%
2005	75.2%
2006	48.2%

In most states, loss ratios have declined to 50% or less. In 2005 – a year in which several states were affected by Hurricanes Katrina and Rita – 20 states had loss ratios below 40% and 20 more states had loss ratios below between 40% and 50%. The increased profitability of homeowners insurance for non-catastrophic coverage is evident from a review of loss ratios in a number of states not subject to the hurricane risk along the southeast coast of the country and even in some southeastern states. For example, just looking at the three most populous states in the country shows loss ratios generally under 50% by 2004. Even in 2005, the year of Hurricane Rita, the Texas loss ratio was only 57%.

Table C: Loss Ratios for Homeowners Insurance (CA, NY, TX)

	2001	2002	2003	2004	2005	2006
CA	64.2%	59.2%	74.2%	30.9%	34.1%	33.3%
NY	55.6%	47.8%	51.5%	47.7%	43.3%	42.7%
TX	115.6%	108.3%	58.5%	28.1%	57.3%	33.8%

IV. CREDIT SCORING AND DISCRIMINATION

The potentially most controversial issue in credit scoring in general, and insurance scoring in particular, is the impact on certain minority groups. Ever since credit scoring became prevalent, there have been concerns that scoring systems contain biases that disproportionately impact minorities and other disaffected groups. These concerns turned out to be justified, as study after study found that certain racial and ethnic groups tend to have lower credit scores than whites. Furthermore, minority consumers are less likely to even have the credit history necessary to generate a credit score.

The insurance industry's defense to charges of discrimination has been to cite (and commission) studies that show insurance scores are predictive. In essence, they are saying that minorities and low-income persons may have lower scores as a group, but they present more risk, so the use of scoring is reasonable and there is no discrimination.

As with their overall defense of insurance scoring, there is a disturbing "moral person" proposition in the insurers' argument with respect to the disparate impact of scoring, although it is never explicitly stated: minorities and low-income consumers are sloppy with their credit (and therefore with their driving). The counter argument is that the disparate impact in credit scoring reflects other correlations - race is correlated with wealth and wealth is correlated with risk because the more wealth one has, the more likely the consumer can "eat" insurance losses. Furthermore, as discussed in Section VI, the correlation between race and wealth is no accident, but a reflection of decades of intentional discrimination and exclusion of minorities from wealth building programs.

The following sections provide a brief overview of the statistical evidence of credit scoring's disparate impact both with respect to generic credit scores used for credit granting as well as insurance scoring specifically. It is important to note, as more fully discussed in Section V below, that a practice might be considered discriminatory because of its disparate impact on a minority group, even if the entity engaged in the practice did not have the intent to discriminate.

A. General Credit Scoring Studies

The first study on the issue of race and credit scores came from home mortgage giant Freddie Mac. This study issued in 1994 found that African Americans were three times as likely to have FICO scores below 620 (a typical threshold for a "bad" credit score) as were whites. The same study showed that Hispanics are twice as likely as whites to have FICO scores under 620.³⁹

During the mid-1990s, Fair Isaac conducted its own study of the relationship between scores and race, in response to concerns over disparate impact. Fair Isaac analyzed 800,000 consumer credit files to see how they performed over a two year period. Fair Isaac also used U.S. Census data to determine if the consumers lived in "high minority areas," employing neighborhood as a proxy for race. Fair Isaac's report found that its scoring models were equally predictive for consumers living in minority neighborhoods as in white neighborhoods. However, this same analysis also clearly showed that consumers living in minority neighborhoods had lower overall credit scores. For

³⁹ Freddie Mac, *Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families*, September 1996, at 27.

example, over one quarter of consumers in minority neighborhoods scored under 620 while less than 14% of consumers in white neighborhoods scored that low.⁴⁰

A few years later, researchers at the University of North Carolina analyzed the credit scores of 5,500 borrowers who had received community reinvestment mortgages. This analysis showed that one-third of African Americans in this pool had credit scores under 620, as compared to only 15 percent of whites. Furthermore, the study found that another one-third of African Americans had credit scores between 621 and 660 (as compared to 20% of whites), which means that two-thirds of African Americans in this pool had what is considered marginal or poor credit.⁴¹

In addition to having lower credit scores, minority consumers are also more likely to lack the credit history necessary to even generate a credit score, because they are less likely to have those forms of traditional credit that get reported to the credit bureaus. The University of North Carolina study discussed above found that 22% of Hispanics did not have enough of a credit history to generate a credit score, as opposed to fewer than 5% of whites.⁴²

A study conducted by Federal Reserve Board researchers in 2003-2004 of over 300,000 credit history files found that fewer than 40% of consumers who lived in high minority neighborhoods had credit scores over 701, while nearly 70% of consumers who lived in mostly white neighborhoods had scores over 701. Furthermore, consumers living in minority and lower-income neighborhoods experienced errors or omissions in credit data more frequently.⁴³

One of the most striking analyses of credit scoring disparities comes from a study published by the Joint Center for Housing Studies at Harvard University.⁴⁴ This study was based on a simulation of credit scores using a set of 200,000 credit files purchased by the Federal Reserve Board, matched with data from the triennial Survey of Consumer Finances. Researchers found that, for the period of 1989 to 2001, the median credit score had increased slightly for the general population. However, this increase masked a tremendous divergence in credit scores during that same period of time.

The study's researchers observed that the median credit score for whites increased significantly during the 1990s, from 727 to 738, while the median credit score for African Americans dropped from 693 to 676. The median score dropped even more for Latinos, from 695 to 670. The percentage of African Americans with credit scores under 660 (which is considered the cut off for "good credit") grew from 27% to 42% and for Latinos it grew from 29% to 49%, while among whites it rose only slightly from 17% to 19%.

⁴⁰ Fair, Isaac & Co., *The Effectiveness of Scoring on Low-to-Moderate Income and High-Minority Area Populations*, Aug. 1997.

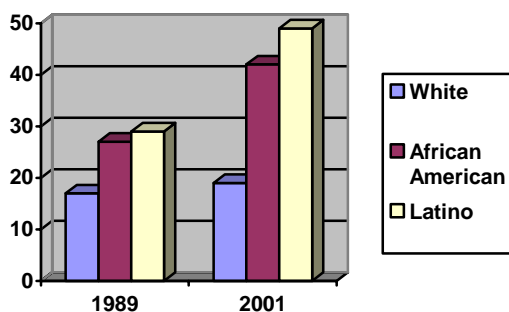
⁴¹ Roberto G. Quercia, Michael A. Stegman, Walter R. Davis and Eric Stein, *Performance of Community Reinvestment Loans: Implications for Secondary Market Purchases*, in *Low Income Homeownership: Examining the Unexamined Goal* (Nicolas P. Retsinas and Eric S. Belsky, eds. 2002), at 363: Table 12-7

⁴² *Id.*

⁴³ Robert B. Avery, Paul S. Calem, and Glenn B. Canner, *Credit Report Accuracy and Access to Credit*, Federal Reserve Bulletin, Summer 2004, at 313 (Table 2).

⁴⁴ Raphael W. Bostic, Paul S. Calem, and Susan M. Wachter, *Hitting the Wall: Credit as an Impediment to Homeownership*, Joint Center for Housing Studies of Harvard University, February 2004.

Table D: Percentage of population with credit scores under 660, by race



The most recent study showing a disparate impact in credit scoring comes from the Brookings Institution.⁴⁵ This study found that counties with relatively high proportions of racial and ethnic minorities are more likely to have lower average credit scores than predominately white counties. In the counties with a very low typical score (scores of 560 to 619), Brookings found that about 19 percent of the population is Latino and another 28 percent is black. On the other hand, the counties that have higher typical credit scores tend to be essentially all white counties. In particular, Brookings noted that in counties with average credit scores between 700 and 719, only about 5.1 percent of the population was Latino and just 1.1 percent was black. The study’s author did caution that his finding was not evidence of bias, but “point[ed] to an association, which frankly is not very well understood...”

An important study on the statistical disparities in credit scoring by race is due (actually overdue) to be issued by the federal government. The Fair and Accurate Credit Transactions Act of 2003 required the Federal Reserve Board, Federal Trade Commission, and the U.S. Department of Housing and Urban Development to study the issue credit scoring and disparate impact in both the credit and insurance context, and to issue a report to Congress.⁴⁶

In addition to racial disparities, there appears to be a growing credit scoring “gap,” in which the divide between “good” and “bad” scorers seems to be growing, reflecting an increasing gulf between the credit haves and have-nots. For example, the Brookings Institution study found that counties with lower average credit scores saw a decline in those scores over a five year period of 17% on average, while counties with higher average scores saw them improve slightly.⁴⁷ This trend suggests that credit scores are “path dependent,” i.e., low scoring consumers tend to see their scores decline while high scorers see them improve. The Brookings report expressed concern that this trend pointed to a “potentially ruinous fiscal cycle” for consumers with low credit scores. The Harvard Joint Center for Housing Studies study revealed similar results, finding that the median credit score for the top quintile of income increased significantly during the 1990s, from 729 to 754, while the median credit score for the bottom quintile dropped from 703 to 688.⁴⁸ Moreover, the percentage

⁴⁵ Matt Fellowes, *Credit Scores, Reports, and Getting Ahead in America*, Brookings Institution, May 2006.

⁴⁶ Fair and Accurate Credit Transactions Act of 2003, Pub. L. No. 108-159, § 215 (2003).

⁴⁷ Matt Fellowes, *Credit Scores, Reports, and Getting Ahead in America*, Brookings Institution, May 2006.

⁴⁸ Raphael W. Bostic, Paul S. Calem, and Susan M. Wachter, *Hitting the Wall: Credit as an Impediment to Homeownership*, Joint Center for Housing Studies of Harvard University, February 2004.

of consumers who scored under 660, and thus have marginal or worse credit, increased from 19% to 25% of the overall population.

B. Insurance Scoring Studies of Race & Scores

A number of state insurance commissions have conducted studies on the relationship between insurance scores and race, as well as gender, age, and income. While the first few studies were not conclusive, the most recent studies showed significant racial disparities similar to those found in the studies of traditional credit scoring.

The first few studies did not produce conclusive results. A study conducted by the Virginia Bureau of Insurance concluded that credit scoring would not be an effective tool for an insurer to redline out minorities, which would be disparate treatment; however, this study did not report findings on disparate impact.⁴⁹ In 2003, the Washington State Insurance Commissioner issued a study that showed a correlation between insurance scores and income. However, its findings regarding the racial impact of insurance scoring were inconclusive, primarily because of the small number of minorities sampled from Washington State's relatively homogeneous population.⁵⁰

A Maryland study showed a correlation between race, income and insurance score, finding that in Baltimore City, the percentage of residents with high credit scores decreased as the percentage of minorities and lower-income households increased in a neighborhood. However, because the study used data prior to the passage of Maryland's statute regulating insurance scoring, the Maryland Insurance Administration declined to conclude that there was sufficient data to determine whether the use of insurance credit scores had an adverse impact on low-income or minority populations.⁵¹

In early 2004, the Missouri Department of Insurance released the first comprehensive study of race and insurance scoring to show definitive disparities.⁵² The Missouri study found a stunning correlation between insurance scores and race, as well as income, age, marital status, and educational attainment. Using credit score data aggregated at the ZIP code level collected from the highest volume insurers in Missouri, the study found:

- Insurance scores were significantly worse for residents of high-minority ZIP codes. The average consumer in an "all minority" neighborhood had a credit score that fell into the 18.4th percentile, while the average consumer in a "no minority" neighborhood had a credit score that fell into the 57.3rd percentile – a difference of 38.9 percentile points.
- Insurance scores were significantly worse for residents of low-income ZIP codes. The average consumer in the poorest neighborhood had a credit score 12.8 percentile points lower than residents in the wealthiest communities.

⁴⁹ Va. Bureau of Ins., *Report on the Use of Credit Reports in Underwriting to the State Commerce and Labor Committee of the General Assembly* (Dec. 1999). For an explanation of the difference between disparate impact & disparate treatment here, see section V below.

⁵⁰ Dave Pavelchek & Bruce Brown, Office of Wash. State Ins. Comm'r, *Effect of Credit Scoring on Auto Insurance Underwriting and Pricing* (Jan. 2003).

⁵¹ Md. Ins. Admin., *Report on the Credit Scoring Data of Insurers in Maryland* (Feb. 2004).

⁵² Brent Kabler, *Insurance-Based Credit Scores: Impact on Minority and Low Income Populations in Missouri*, Missouri Department of Insurance – Statistics Section, January 2004.

- The correlation between race (high minority neighborhoods) and credit scores remained even after eliminating other variables, such as income, education, marital status, and unemployment. Residency in a minority concentration neighborhood proved to be the single most reliable predictor of credit scores.
- The gap in credit scores translated to the individual level. The average gap between the percentage of minorities with poor scores and non-minorities with poor scores was 28.9 points. The gap between lower-income and higher-income households was 29.2 percentage points.

The author and researcher of the Missouri study concluded that “the evidence appears to be credible, substantial, and compelling that credit scores have a significant disproportionate impact on minorities and on the poor.”

About a year later, the Texas Department of Insurance issued a study with similar findings.⁵³ Instead of using geographic neighborhood as a proxy for race, the Texas study was able to determine the actual race of policyholders by using motor vehicle records for approximately 2 million consumers. The Texas study found dramatic disparities by race, finding African Americans and Hispanics were over-represented in the lower credit score categories and under-represented in the better credit score categories.

- African Americans constituted 33% of consumers with the worst scores and only 2% of the consumers with the best scores. African Americans were about 13% of the population of the policyholders sampled.
- Hispanic consumers constituted 28% of consumers with the worst scores and only 5% of consumers with the best scores. About 19% of the population of the policyholders sampled was Hispanic.
- In total, African Americans and Latinos constituted over 60% of consumers having the worst credit scores but fewer than 10% of those having the best scores. (Asian Americans had scores that were the same or slightly worse than whites.) The Texas study concluded there was a consistent pattern of differences in credit scores among racial and ethnic groups, with whites and Asian Americans faring better than African Americans and Hispanics.
- The Texas study also found disparities by income, though they were less dramatic than those for race. The average credit scores for upper income consumers were better than those for lower and moderate income populations. Additionally, the moderate income populations tended to be over-represented in the worse than average credit score categories and under-represented in the better than average credit score categories.

⁵³ Texas Department of Insurance, *Report to the 79th Legislature - Use of Credit Information by Insurers in Texas*, December 30, 2004.

C. A Less Discriminatory Alternative

As we have noted, the difficult issue with credit scoring is that while it has a disparate impact, it is predictive in the credit context and claimed to be predictive in an insurance context as well. Thus, our society is faced with the decision of whether to permit the employment of a useful tool knowing that it not only disproportionately hurts minorities, but also perpetuates a historical legacy of discrimination.

One possible solution to this quandary is the idea of the “less discriminatory alternative” from civil rights law, which is discussed in Section V below. In disparate impact cases, a plaintiff can argue that a practice is discriminatory even if the defendant did not intend to discriminate. The defendant can then defend the practice if it can show a business necessity for the practice. If the defendant makes this showing, the plaintiff can still prove discrimination by demonstrating there is another equally usefully tool that can be used to fulfill the same necessity but that tool has less of a discriminatory impact on minorities.

There is evidence that such tools exist. For insurance, at least one study has found that formulas using attributes other than credit score yield almost the same correlations with loss ratios as formulas that use credit scores.⁵⁴ The settlement of a major discrimination lawsuit against Allstate resulted in that company implementing a new credit scoring algorithm which supposedly results in less disparate impact to minorities.⁵⁵

In the credit granting context, researchers have shown evidence that the credit scoring models themselves could be modified so as to reduce racial disparities, at least for credit granting purposes.⁵⁶ Ironically, such modifications would need to actively take race into account. For example, one modification proposed by researchers would require including minority status as a “control variable” during the development of a credit scoring model.⁵⁷

Taking race into account to eliminate racial disparities is not a new concept in civil rights law. As Supreme Court Justice Harry Blackmun noted, “In order to get beyond racism, we must first take account of race. There is no other way.”⁵⁸

⁵⁴ Wayne D. Holdredge and Katharine Barnes, *Good News, Bad News or Both?*, Tillinghast-Towers Perrin, February 2003.

⁵⁵ *DeHoyos v. Allstate Corp.*, 240 F.R.D. 269 (W.D. Tex. 2007).

⁵⁶ Michael LaCour-Little and Elaine Fortowsky, *Credit Scoring and the Fair Lending Issue of Disparate Impact in Credit Scoring for Risk Managers: The Handbook for Lenders* (Elizabeth Mays ed. South-Western Educational Pub. 2003); Elaine Fortowsky and Michael LaCour-Little, *Credit Scoring and Disparate Impact* (Dec. 2001), available at <http://fic.wharton.upenn.edu/fic/lacourpaper.pdf>.

⁵⁷ *Id.* at 20.

⁵⁸ *University of California Regents v. Bakke*, 438 U.S. 265, 98 S. Ct. 2733 (1978).

V. LEGAL STATUS OF INSURANCE SCORING

In this section, we review both the current legal status of insurance scoring and the challenges actually filed or potentially possible using anti-discrimination laws.

A. *State Insurance Laws*

Many states have passed legislation regarding the practice of insurance scoring.⁵⁹ Most of these statutes are based on a model law developed by the National Conference of Insurance Legislators (NCOIL).⁶⁰ The NCOIL model law permits insurance scoring and is viewed positively by the insurance industry.⁶¹ It does contain some protections for consumers, such as prohibiting insurers from treating negatively the fact that a consumer has no credit cards or has medical bills sent to a collection agency. However, the enactment of the NCOIL model in many states is seen by advocates as anti-consumer, because it either permitted insurance scoring where it had not been permitted before, or at a minimum, legitimized the practice and prevented a stronger ban from being enacted.⁶² State insurance regulators have attempted to rein in insurance credit scoring as well.⁶³

B. *Discrimination Challenges to Insurance Credit Scoring*

The dramatic racial disparities in credit scoring raise the obvious question whether the practice can be challenged as discriminatory. The answer to this question is complex and depends on whether the product at issue is credit, homeowner's insurance, or auto insurance.

There are two main types of discrimination theories under civil rights law - disparate treatment and disparate impact (or the "effects" test). Disparate treatment occurs when a business or employer treats a person differently on the basis of race or another prohibited basis (gender, age, religion, etc.). Disparate impact occurs when a business's policy or practice, neutral on its face, has a disproportionate negative impact on a protected group. Under this theory, the business's motive in treating applicants differently might not be race or another prohibited basis, but the effect is to adversely impact a particular protected class.

⁵⁹ For a summary of some of these laws, see National Consumer Law Center, Fair Credit Reporting, Appendix H, (6th ed. 2006).

⁶⁰ National Conference of Insurance Legislators, *Model Act Regarding Use Of Credit Information In Personal Insurance*, November 22, 2002.

⁶¹ National Ass'n of Mut. Ins. Cos., *NAMIC's State Laws and Legislative Trends State Laws Governing Insurance Scoring Practices*, undated, available at www.namic.org/reports/credithistory/credithistory.asp.

⁶² See Testimony of Birny Birnbaum, Center for Economic Justice, Before the Colorado House Finance Committee, February 18, 2004, available at <http://www.cej-online.org/bb%20co%20test%20040218.pdf>.

⁶³ See, e.g., Florida Office of Insurance Regulation, *Use of Credit Reports and Credit Scores by Insurers*, Informational Memorandum OIR-06-10M, May 22, 2006, available at <http://www.floir.com/Memoranda/OIR-06-10M.pdf> (last visited June 2007) (requires insurers to demonstrate that their use of credit reports and credit scores does not disproportionately affect persons of any race, color, religion, marital status, age, gender, income, national origin, or place of residence). However, an administrative law decision has forced the Florida regulator to propose a new rule. The Michigan Insurance Commissioner attempted to ban the use of insurance credit scores; however, that rule was struck down by a Michigan court. *Michigan Judge Shoots Down Proposed Credit-Scoring Ban*, BestWire Services, April 26, 2005.

1. Elements of a disparate impact challenge

Only certain anti-discrimination laws allow for a disparate impact challenge to be brought. In the credit area, the Equal Credit Opportunity Act (ECOA) prohibits racial discrimination in the granting of credit in general, while the Fair Housing Act (FHA) prohibits discrimination in mortgage lending. Both of these laws permit a disparate impact claim to be brought.⁶⁴ However, the ECOA probably does not cover discrimination in insurance.⁶⁵ The FHA does apply to insurance as well as credit, but only where housing is involved.⁶⁶

In order to make out a “prima facie” or initial case for disparate impact, the plaintiff must:

- **Identify** a specific policy (e.g., use of credit scores) that has a discriminatory effect;
- **Show a disparate impact** of the policy on a group protected by anti-discrimination laws; and
- **Show causation**, i.e. a link between the policy and the disparate impact.

Making out a prima facie case of disparate impact does not necessarily mean that a practice violates the ECOA or FHA. Under the disparate impact analysis, a creditor or company can defend its policy by showing a “business necessity.” Courts have articulated a number of different tests and definitions of “business necessity,” including “compelling need,” “manifest relationship,” “legitimate, non-discriminatory rationale,” and “demonstrably necessary.”⁶⁷

With respect to ECOA, the Federal Reserve Board (which interprets that law) has indicated that creditors can defend a policy that produces disparate impact by showing “a demonstrable relationship between” the challenged policy and “creditworthiness.”⁶⁸ Thus, if a variable or factor in a credit scoring model causes a disparate impact, but is “demonstrably related” to creditworthiness, it may be permissible under fair lending laws. The variable or factor, however, must be related to creditworthiness and not some other reason, such as generating maximum profit.

Note that the business necessity analysis may differ for scoring models used for credit versus insurance. Credit scores are based on credit histories, and supposedly measure the consumer’s likelihood of repaying a loan. There is an understandable connection to their use to measure creditworthiness, and thus a “demonstrable relationship” argument can be easily made. While there might be some correlation between insurance credit scores and loss history, there has been no definitive understandable reason provided as to why credit scores are a good measure of “insurance worthiness.” However, one of the first courts to deal with the issue did hold that insurance scoring’s supposed predictiveness constitutes a business necessity, as discussed below.⁶⁹

Furthermore, there is one final step in a disparate impact analysis -- whether there is a less discriminatory alternative that can be used to meet the “business necessity.” As discussed above,

⁶⁴ National Consumer Law Center, *Credit Discrimination*, § 4.3.1 (4th ed. 2005 and Supp.).

⁶⁵ *Id.* at § 7.3.4.1.

⁶⁶ *Id.* at § 7.3.4.2.

⁶⁷ *Id.* at § 4.3.2.5.

⁶⁸ Official Staff Commentary to Regulation B, 12 C.F.R. § 202.6(a)-2.

⁶⁹ *Owens v. Nationwide Mutual Insurance Co.*, 2005 WL 1837959 (N.D. Tex. Aug. 2, 2005).

there are suggestions that viable alternatives to credit scoring exist in both the credit and insurance context that are less discriminatory toward minorities.

2. Is a disparate impact analysis available in insurance cases?

A disparate impact analysis is clearly available to challenge the use of credit scoring in the credit granting arena.⁷⁰ With respect to insurance, the availability of this theory is mixed, and depends on whether the product is homeowners versus automobile insurance.

Homeowners insurance is covered by one of the federal anti-discrimination laws, the Fair Housing Act.⁷¹ As the Seventh Circuit Court of Appeals aptly noted: “no insurance, no loan; no loan, no house.”⁷² Thus, the racial disparities created by insurance scoring in homeowners insurance could be challenged under the Fair Housing Act. To date, the leading major legal challenge brought against insurance scoring using this theory is *DeHoyos v. Allstate Corp.*, 345 F.3d 290 (5th Cir. 2003). This case ultimately resulted in a settlement that required Allstate to implement a new credit scoring algorithm which supposedly results in less disparate impact to minorities, and to refund from \$50 to \$150 to policyholders who filed a claim and whose scores rose due to the new formula.⁷³

The initial challenge that the plaintiffs in *DeHoyos* had to overcome was the McCarran-Ferguson Act. Enacted in 1945, McCarran-Ferguson prohibits any federal law interpretation that invalidates, impairs, or supersedes any state insurance law unless the federal law specifically relates to insurance regulation.⁷⁴ The Fifth Circuit in *DeHoyos* held that applying the Fair Housing Act and anti-discrimination laws did not ‘impair’ any Texas or Florida insurance law. In *DeHoyos*, however, there was no state insurance law explicitly allowing or condoning insurance scoring at that time. A potential issue is that many states (including Texas after the *DeHoyos* decision) have enacted laws allowing for or condoning credit scoring.⁷⁵ However, every federal Court of Appeal considering the issue has rejected the argument that McCarran-Ferguson preempts an insurance discrimination lawsuit based on federal civil rights laws.⁷⁶

The next hurdle for a disparate impact challenge to the use of credit scores in homeowners insurance is to counter the supposed predictiveness of scoring. At least one federal District Court has already accepted at face value the argument that the predictiveness of credit scores presents an adequate “business necessity” to withstand a disparate impact challenge.⁷⁷ The court engaged in little analysis of whether credit scores are truly predictive and why a credit history is related to the “insurance-worthiness” of a consumer. The court also accepted the insurance company’s claim that without the use of scoring, it would be at a competitive disadvantage. This latter reason seems

⁷⁰ For a discussion of cases that have challenged credit scoring, see National Consumer Law Center, *Credit Discrimination*, § 6.4.4 (4th ed. 2005 and Supp.).

⁷¹ *Id.* at § 7.3.4.2.1.

⁷² *N.A.A.C.P. v. Am. Family Mut. Ins. Co.*, 978 F.2d 287, 297 (7th Cir. 1992).

⁷³ *DeHoyos v. Allstate Corp.*, 240 F.R.D. 269 (W.D. Tex. 2007).

⁷⁴ 15 U.S.C. § 1012(b).

⁷⁵ Tex. Ins. Code art. 21.49-2U. See William Goddard, *Swimming in the Wake of DeHoyos: When Federal Courts Sail Into Disparate Impact Waters, Will State Regulation of Insurance Remain Above the Waves?* 10 Conn. Ins. L. J. 369 (2003-2004).

⁷⁶ National Consumer Law Center, *Credit Discrimination*, § 7.3.4.2.2 (4th ed. 2005 and Supp.).

⁷⁷ *Owens v. Nationwide Mutual Insurance Co.*, 2005 WL 1837959 (N.D. Tex. Aug. 2, 2005). The court also held that the supposed predictiveness of insurance scores presented a “legitimate nondiscriminatory reason” to rebut a prima facie showing of disparate treatment under the McDonnell Douglas test.

questionable, because it implies that discrimination cannot be challenged if it is an industry standard, *i.e.*, if everyone discriminates, no one can be held accountable for discrimination.

Note that the plaintiff in this case appears to have failed to present evidence or an argument regarding a less discriminatory alternative. As discussed in Section IV.C above, there is evidence that less discriminatory alternatives exist, and this may be the best argument both legally and on a policy basis to argue against the form of insurance scoring now used by the industry.

As for automobile insurance, there may be few avenues to bring a disparate impact challenge to the use of credit scoring in that context. Discrimination in auto insurance is not generally covered under any federal law. Instead, one would need to look at the anti-discrimination provisions of state insurance laws. While approximately 40 states have anti-discrimination provisions in their insurance laws, many of these states do not allow for consumers to bring a private lawsuit under those laws.⁷⁸ Furthermore, there is no clear authority that these laws provide for disparate impact challenges.

One other potential source of legal challenge to insurance scoring might be state laws that prohibit discrimination by ‘places of public accommodation.’ However, the availability of a disparate impact challenge under these state laws is mixed at best.⁷⁹ Furthermore, it is unclear whether state statutes would consider an insurance company a ‘place of public accommodation.’⁸⁰ Finally, there may be county or municipal human relations laws that might cover auto insurance and provide a disparate impact challenge.

C. Disparate Treatment

Finally, one should not rule out the possibility of a disparate treatment analysis in challenging insurance scoring.⁸¹ Given the very well-documented and well-publicized, controversial link between credit scores and race, it would not be unthinkable to argue that insurers may be tempted to use credit scoring exactly for the reason that it would screen out minorities from their pool of insured.

There are two methods to prove disparate treatment: direct proof and circumstantial evidence. Since very few businesses these days openly admit outright discrimination, many disparate treatment cases will rely on a circumstantial evidence test developed in the employment law area called the McDonnell Douglas test.⁸² The McDonnell Douglas test, as adapted in the credit (or insurance) context, requires the plaintiff to show:

- membership in a protected class;

⁷⁸ National Consumer Law Center, *Credit Discrimination*, § 7.3.4.4 (4th ed. 2005 and Supp.).

⁷⁹ For example, Minnesota, the District of Columbia and New York City civil rights laws permit disparate impact challenges. *Paper v. Rent-A-Wreck*, 463 N.W.2d 298 (Minn. Ct. App. 1991) (Minnesota); *Mitchell v. DCX, Inc.* 274 F.Supp.2d 33 (D.D.C. 2003) (District of Columbia); *Levin v. Yeshiva University*, 754 N.E.2d 1099 (N.Y. 2001)(New York City). California and Ohio public accommodations laws do not. *Harris v. Capital Growth Investors XIV*, 805 P.2d 873 (Cal. 1991)(California); *Derungs v. Wal-Mart*, 141 F.Supp.2d 884 (S.D. Ohio 2000)(Ohio).

⁸⁰ For example, under federal law, Title II of the Civil Rights Act of 1964 also prohibits discrimination by places of public accommodation; however, an insurance company does not fit into the definition of public accommodation in that statute. 42 U.S.C. § 2000a.

⁸¹ A disparate treatment claim could be brought under the Civil Rights Acts of 1866. 42 U.S.C. §§ 1981 and 1982.

⁸² This test is derived from the U.S. Supreme Court’s decision in *McDonnell Douglas Corp. v. Green*, 411 U.S. 792 (1973).

- application for credit (or insurance) for which the plaintiff was qualified;
- rejection despite qualification; and
- that the defendant continued to approve credit for similarly qualified applicants.⁸³

There is an obvious circularity in the McDonnell Douglas test – what if a criterion being used for qualification is itself the alleged discriminatory conduct (*e.g.*, in the context of discrimination against public assistance recipients, what if the criterion for qualification is having employment) or a pretext for discrimination (as credit scores might be). Can that factor be included in analyzing whether the plaintiff is qualified for the credit or insurance? At least one court has held that a low credit score means that the plaintiff will not be able to make out a *prima facie* case under the modified McDonnell Douglas test.⁸⁴

Also, the modified McDonnell Douglas test only applies when a consumer is rejected for credit or insurance. If a consumer receives the credit or insurance, a reverse redlining analysis is required. In that context, the applicable test is:⁸⁵

- Plaintiff is a member of a protected class;
- She applied for and was qualified for credit;
- Credit was given to her on grossly unfavorable terms; and
- The lender continues to provide loans to other applicants with similar qualifications but on significantly more favorable terms.

Again, a critical issue is whether the disputed criteria (*i.e.*, credit scoring) can be used as a “similar qualification” to compare minority and white applicants.

VI. REVERSE SOCIAL ENGINEERING THROUGH CREDIT SCORING

Credit scoring has become the numerical expression of the racial economic divide and wealth gap in this country. As such, it essentially serves as a proxy for certain behaviors that our society has sought to discourage these past few decades, including -

- redlining (refusing to make loans to or insure communities of color)
- reverse redlining (charging more to communities of color)
- denying services to low-income communities
- charging more to low-income communities.

⁸³ National Consumer Law Center, Credit Discrimination, § 4.2.3.1 (4th ed. 2005 and Supp.).

⁸⁴ Curley v. JP Morgan Chase Bank, N.A., 2007 WL 1343793 (W.D. La. May 7, 2007).

⁸⁵ National Consumer Law Center, Credit Discrimination, § 4.2.3.3 (4th ed. 2005 and Supp.).

From a social policy standpoint each of these behaviors is considered destructive and reprehensible. They are also behaviors that can be highly profitable. Thus, the ability to use credit scoring is a way for lenders, insurers, employers, and others to reap the economic benefits of racial and economic discrimination without having to admit they are discriminating and without being barred from doing so by anti-discrimination laws. As even a high-level Fair Isaacs official admitted:

Unfortunately, income, property, education, and employment are not equally distributed by race/national origin in the United States. Since all of these factors influence a borrower's ability to meet financial obligations, it is unreasonable to expect an objective assessment of credit risk to result in equal acceptance and rejection rates across socioeconomic or race/national origin lines. By definition, low-income borrowers are economically disadvantaged, so one would not expect their score distributions to mirror those of higher-income borrowers.⁸⁶

The effect of credit scoring is to create a spiraling down situation, in which minority and low-income consumers are denied credit and insurance, or forced to pay much more for it. The drain on income affects their ability to pay their current bills, let alone build assets to move ahead. These communities fall further and further behind while wealthy white communities get a break on their credit and insurance needs. Credit scoring widens and deepens the gap between haves and have-nots.⁸⁷

In insurance, credit scoring runs counter to the fundamental concept of spreading the risk of loss. Credit scoring results in the insurance companies being able to shed consumers they don't want by denying them coverage or setting prices so high as to be unaffordable. What is the sense of an insurance system that permits insurance companies to cherry pick only well-to-do suburban Caucasians as consumers?

Finally, some might think it is an unfortunate fact that blacks and Latinos are less wealthy, but "that's life" and it should be no reason to change social policy. Groundbreaking research during the last several years shows, however, that the wealth gap is no accident. The wealth gap was created by policies that deliberately benefited whites while excluding African Americans and other racial minorities.⁸⁸ For example, during the early years of the Social Security program, pensions were denied for many years to domestic and agricultural workers —two of the most significant black occupations.⁸⁹ Unemployment insurance and the minimum wage did not apply to domestic workers or farm workers either.⁹⁰ Another striking example is that, of the 3,229 GI Bill-guaranteed loans for homes, businesses, and farms made in Mississippi in 1947, only two were offered to black veterans.⁹¹

⁸⁶ Fed. Reserve Bank of Boston, *Perspectives on Credit Scoring and Fair Lending: A Five-Part Article Series* (pt. 1), Communities & Banking, Spring 2000, at 2 (statement of Statement of Peter L. McCorkell, Executive Vice President & General Counsel, Fair Isaac).

⁸⁷ Indeed, some insurance companies have decided to skip the step of credit scoring and go straight to directly discriminating against low-income consumers. For example, at least one insurance company has adopted guidelines that directly base insurance rates and eligibility on the factors of education and occupation. Press Release, *GEICO Ties Insurance Rates to Education, Occupation*, Consumer Federation of America, March 20, 2006.

⁸⁸ See Meizhu Lui, et al., *The Color of Wealth: The Story Behind the U.S. Racial Wealth Divide* (The New Press 2006).

⁸⁹ *Id.* at 92-93.

⁹⁰ *Id.*

⁹¹ *Id.* at 97.

In short, the racial disparities of credit scoring perpetuate the racist policies of decades past. The playing field was never level, and credit scoring preserves that advantage for whites and the well off. The use of credit scoring given the historical legacy of discrimination would be akin to excluding a sports team from playing games during the first half of a season, considering all those games to be losses, calculating the team's rankings on the basis of those "losses," and then telling the team they could not participate in the playoffs because of their shoddy record.

VII. POLICY RECOMMENDATIONS

Credit scores represent a numerical reflection of the enormous racial wealth gap in this country. As such, their use in insurance - which determines whether a person will be able to own a home or afford to drive a car - perpetuates racial and economic inequality. State legislatures can and should have a role in limiting the use of insurance scores by:

- Enacting laws to ban insurance scoring.
- If insurance scoring continues to be permitted, regulators should require the development and use of scoring models that have less of a discriminatory impact on minority groups. After all, it appears that insurers have tools equally effective as credit scores to control for loss. Regulators should consider requiring insurers and scoring companies to take measures that actively reduce the effect of past racism.

APPENDIX A

Description of Excess Premium Analysis in Tables 1, 2 and 3

This analysis asks: what would premiums have been if insurers had charged rates that were reasonable in relation to actual losses incurred for private passenger automobile insurance?

Tables 1 and 2 show the analyses separately for private passenger automobile liability and physical damage coverages. Liability coverages include bodily injury and property damage liability, personal injury protection, medical payments and uninsured and underinsured motorists' coverages. Physical damage coverages include collision and comprehensive coverages. Table 3 provides a summary of Tables 1 and 2 for all private passenger automobile insurance combined.

Description of Data Sources, Data Elements and Calculations for Tables 1 and 2

Line 1 is the pure loss ratio – the ratio of incurred losses to earned premium. Earned premium is essentially the premium associated with the coverage in force during the calendar year. For example, if an insurer issued a six month policy on October 1 with a premium of \$1,000, the earned premium for the year in which the policy was issued would be about \$500 and also about \$500 in the following year.

Incurred losses are essentially the insurer's estimate of losses it will eventually pay out for policies issued during the calendar year. Incurred losses are losses actually paid during the year plus changes in loss reserves during the year. If insurers are estimating reserves accurately, losses eventually paid for a particular year's worth of policies should equal the incurred losses initially established for that year's worth of policies. Insurers have, however, overstated loss reserves for private passenger automobile insurance frequently in years where incurred loss percentages are high with the result that the ultimate payouts have been less than the initial estimates reflected in the ratio of incurred losses to earned premiums.

The data for the loss ratios come from the "Countrywide Direct" page of the Countrywide Profitability Results by Line section of the National Association of Insurance Commissioners *Report on Profitability by State by Line* for the years 1995 through 2005. These data are compilations of reports by insurance companies on the state pages of the statutory annual statement – Column 6, Direct Losses Incurred divided by Column 2, Direct Premiums Earned.⁹² Year 2006 loss ratios were calculated from countrywide earned premium and incurred loss data compiled from the state pages. The raw data for all companies and all states were provided as a dataset by the NAIC. The 2006 data are preliminary. Earned premiums and incurred losses were compiled from the data and the loss ratios calculated. The NAIC is not responsible for any calculations or compilations developed from the data it provides.

Line 2 is the amount of loss settlement expense as a percentage of earned premiums as reported in the NAIC *Profitability Reports* on the same pages as the loss ratios in Line 1. The year 2006 percentage was assumed to be the average of the 2003 through 2005 three-year period.

⁹² The source of the data for homeowners insurance is the state page data from the statutory annual statement, as compiled by and reported in various issues of the *Property Insurance Report*.

Line 3 is the provision for fixed expenses, based on the decision by the Texas Insurance Commissioner in an industry-wide rate hearing in 1999 and 2000 – Commissioner’s Order 00-0909, Private Passenger and Commercial Automobile Insurance Benchmark Hearing, Docket 454-00-0408. Fixed expenses include Other Acquisition and General Expenses – which are reporting categories on the state pages described for Lines 1 and 2 – offset for a reduction for excess expenses and for income from installment fees. The actual amounts used are 8.56% for liability coverages and 8.54% for physical damage coverages

Line 4 is the provision for variable expenses, also based on the Texas Insurance Commissioner’s benchmark rate order cited in the Line 3 description. Variable expenses include commissions, taxes licenses and fees and the profit provision. The profit provision includes a reasonable return on capital offset by investment income earned by the insurer. The actual amounts used are 8.26% for liability coverages and 12.56% for physical damage coverages. The difference between the provisions for liability and physical damage coverages results from a greater profit provision for physical damage coverage because of less investment income earned for physical damage coverages than for liability coverages. The lesser investment income is a result of smaller reserves held for shorter periods of time and less capital per dollar of premium for physical damage coverage than for liability coverages – there is less money per dollar of premium to earn investment gains for physical damage coverages than for liability coverages.

Line 5 is the calculation of excessive premium as a percentage of the premium dollar. It is the sum of Lines 1, 2 and 3 divided by the number 1 less Line 4. If rates had been reasonable, this calculation would produce the value zero. The calculation specifically accounts for variable expenses as a percentage of premium with the result that variable expenses are a smaller dollar amount with a low loss ratio associated with excessive rates and premium.

Line 6 reports the direct premiums earned, and comes from the same page in the NAIC *Profitability Report* as the loss ratios in Line 1. Year 2006 loss ratios were calculated from countrywide earned premium and incurred loss data compiled from the state pages. The raw data for all companies and all states were provided as a dataset by the NAIC. The 2006 NAIC data are preliminary. Earned premiums and incurred losses were compiled from the data and the loss ratios calculated. The NAIC is not responsible for any calculations or compilations developed from the data it provides.

Line 7 is the calculation of excessive premiums in dollars, calculated by multiplying the percentage excessive in Line 5 times the earned premiums in Line 6.

Table 3 is the combination of Tables 1 and 2. Line 1 in Table 3 is the aggregate loss ratio for liability and physical damage coverages combined and is provided for information purposes. Line 1 is not used in the calculation of Lines 2 through 4 of Table 3. The data from Lines 1 and 2 come from the same sources as Lines 1 and 2 for Tables 1 and 2. Lines 3 and 4 in Table 3 are the sum of Lines 5 and 6 in Tables 1 and 2. Line 2 is calculated by dividing Line 4 by the difference between Line 3 and Line 4.

Table 1: Private Passenger Automobile Liability

	1999	2000	2001	2002	2003	2004	2005	2006
Incurred Loss / Earned Premium	67.6%	74.3%	76.6%	72.1%	66.4%	62.5%	62.3%	59.5%
Loss Settlement Expense / EP	14.4%	14.5%	14.5%	14.4%	14.0%	13.6%	14.0%	13.9%
Fixed Expense Provision	8.6%	8.6%	8.6%	8.6%	8.6%	8.6%	8.6%	8.6%
Variable Expense Provision	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%	8.3%
% Excessive	1.3%	-6.1%	-8.6%	-3.6%	3.0%	7.7%	7.5%	10.7%
Earned Premium (\$ 000)	69,666,735	69,766,221	73,779,662	80,712,942	88,836,953	93,790,088	95,669,288	96,276,656
Incurred Loss / Earned Premium	896,084	(4,273,884)	(6,369,467)	(2,920,939)	2,692,029	7,238,215	7,174,675	10,298,615

Table 2: Private Passenger Automobile Physical Damage

	1999	2000	2001	2002	2003	2004	2005	2006
Incurred Loss / Earned Premium	63.4%	67.3%	67.4%	61.3%	58.0%	53.1%	57.0%	55.6%
Loss Settlement Expense / EP	9.8%	10.0%	10.2%	9.7%	9.4%	9.4%	10.6%	9.8%
Fixed Expense Provision	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%
Variable Expense Provision	12.6%	12.6%	12.6%	12.6%	12.6%	12.6%	12.6%	12.6%
% Excessive	6.5%	1.8%	1.5%	9.0%	13.2%	18.8%	12.9%	15.4%
Earned Premium (\$ 000)	48,097,634	50,820,838	54,770,914	59,566,494	63,731,080	65,919,070	66,196,538	66,366,645
Incurred Loss / Earned Premium	3,135,367	929,933	814,298	5,381,694	8,381,832	12,363,595	8,554,676	10,246,451

Table 3: Private Passenger Automobile Total

	1999	2000	2001	2002	2003	2004	2005	2006
Incurring Loss / Earned Premium	65.9%	71.3%	72.7%	67.5%	62.8%	58.6%	60.1%	57.9%
% Excessive	3.5%	-2.7%	-4.1%	1.8%	7.8%	14.0%	10.8%	14.5%
Earned Premium (\$ 000)	117,764,369	120,587,059	128,550,576	140,279,436	152,568,033	159,709,158	161,865,826	162,643,301
Incurring Loss / Earned Premium	4,031,451	(3,343,951)	(5,555,170)	2,460,755	11,073,861	19,601,810	15,729,351	20,545,066

ChoicePoint Attract Standard Auto
Thick File (4 trades or more) Scorecard 1 Specifications

Description	Interval	Points
Constant		1.324190
Number of Consumer Initiated Inquiries in the Last 6 Months less Insurance Inquiries Auto & Mortgage de-dupped within 30 days	0	0.000000
	1	0.034436
	2	0.068872
	3	0.103308
	4 or more	0.194308
Number of Accounts Opened in the Last 24 Months	0	0.000000
	1	0.014649
	2	0.029298
	3	0.043947
	4	0.058596
	5	0.073245
	6 - 7	0.093573
	8 or more	0.144287
Worst Credit Rating Currently Reported	rate 0 or 1	0.022979
	rate 2, 3 or 4	0.057223
	rate 5	0.114895
	bad debt	0.137874
	no trades	0.000000
Number of Accounts with 30 Day Late Payments Reported in the Last 24 Months	0	0.000000
	1	0.035667
	2	0.071334
	3 or more	0.137461
Average Number of Months Bank Revolving Accounts have Been Opened	0 - 10	-0.000747
	11 - 21	-0.010830
	22 - 29	-0.016914
	30 - 36	-0.021817
	37 - 41	-0.025729
	42 - 46	-0.029010
	47 - 52	-0.032628
	53 - 57	-0.036245
	58 - 62	-0.039535
	63 - 67	-0.042818
	68 - 72	-0.046121
	73 - 78	-0.049712
	79 - 85	-0.053957
	86 - 93	-0.058909
	94 - 103	-0.064767
	104 - 116	-0.072174
	117 - 142	-0.084155
143 or more	-0.121757	
no bank rev	-0.000747	
no trades	0.000000	
Number of Department Store Accounts	1	0.013451
	2	0.026902
	3	0.040353
	4	0.053804
	5	0.067255
	6	0.080706
	7 or more	0.112573
no trades	0.000000	
Number of Department Store Accounts with a Balance 50% or more of High Credit/Credit Limit	0	0.000000
	1	0.045929
	2 or more	0.110517
# of Sales Finance Accts with Current 60 Day Late Payments	0	0.000000
	1 or more	value*0.350166
Number of Retail Accounts	1	0.039345
	2	0.078690
	3 or more	0.150464
	no retail	0.000000

ChoicePoint Attract Standard Auto
Thick File (4 trades or more) Scorecard 1 Specifications

Description	Interval	Points
Number of Automotive Related Accounts that are Open	0	0.000000
	1 or more	0.075675
Number of Auto Finance Accts that are Open	0	0.000000
	1 or more	0.056152
Number of Oil Company Accounts	1 or more	0.000000
	no oil accts	0.128537
Average Debt Burden on Open Bank Revolving Accts (balance/credit limit)	0.0000 - 0.0027	0.000007
	0.0028 - 0.0193	0.001535
	0.0194 - 0.0415	0.004325
	0.0416 - 0.0721	0.008092
	0.0722 - 0.1139	0.013273
	0.1140 - 0.1697	0.020310
	0.1698 - 0.2407	0.029438
	0.2408 - 0.3259	0.040727
	0.3260 - 0.4232	0.053978
	0.4233 - 0.5295	0.068737
	0.5296 - 0.6435	0.084711
	0.6436 - 0.7561	0.101102
	0.7562 - 0.8582	0.116753
	0.8583 - 0.9374	0.129948
0.9375 - 0.9934	0.139525	
Average Debt Burden on Open Sales Finance Accts (balance/credit limit)	0.9935 or more	0.162900
	no bank rev	0.000000
	0.0000 - 0.5993	-0.001313
% of Bank Revolving Accounts that are Open to Total Number of Accounts that are Open	0.5994 - 9.9992	-0.096070
	no sales fin	-0.001313
	no trades	0.000000
% of Bank Revolving Accounts that are Open to Total Number of Accounts that are Open	0.0000 - 0.1379	-0.003747
	0.1380 - 0.1600	-0.027352
	0.1601 - 0.1935	-0.032241
	0.1936 - 0.2424	-0.039383
	0.2425 - 0.2973	-0.049675
	0.2974 - 0.3226	-0.057539
	0.3227 - 0.3721	-0.063818
	0.3722 - 0.3939	-0.071483
	0.3940 - 0.4419	-0.077885
	0.4420 - 0.4878	-0.085659
	0.4879 - 0.5676	-0.095918
	0.5677 - 0.6585	-0.113325
	0.6586 - 0.7442	-0.128049
	0.7443 or more	-0.167558
	no bank rev	-0.003747
	no trades	0.000000

Score Calculation

Calculate score 1 for thick files by summing the points assigned above and applying the transformation in the last step. Use six decimal precision for all calculations.

Score Transformation

To Calculate Total Points:
TOTPTS = Sum of Assigned Points
To Calculate Thin File Score 1:
PREDSR1 = exp (TOTPTS) - 1

**ChoicePoint Attract Standard Auto
Thick File (4 trades or more) Scorecard 2 Specifications**

Description	Interval	Points
Constant		412.620196
Number of Collection Items less Medical	0	0.000000
	1	-6.642567
	2 or more	-23.116004
Number of Consumer Initiated Inquiries with Finance Companies in the Last 24 Months Auto & Mortgage de-dupped within 30 days	1	-6.393131
	2	-12.786262
	3 - 4	-21.492533
	5 or more	-46.812203
	no inquiries	0.000000
Number of Open Accounts	0 - 1	7.865267
	2	20.207704
	3	30.311556
	4	40.415408
	5	50.519260
	6	60.623112
	7	70.726964
	8	80.830816
	9	90.934668
	10	101.038520
	11	111.142372
	12 - 13	125.567989
	14 or more	169.555266
	Total Amount of Balances Owed on Open Accts	0 - 5	0.000015
6 - 208		0.029245
209 - 504		0.102230
505 - 907		0.203407
908 - 1435		0.338787
1436 - 2102		0.513136
2103 - 2913		0.729978
2914 - 3862		0.985070
3863 - 4964		1.285038
4965 - 6212		1.626599
6213 - 7652		2.020378
7653 - 9275		2.467206
9276 - 11089		2.968070
11090 - 13178		3.537599
13179 - 15606		4.192683
15607 - 18626		4.979101
18627 - 22485		5.975215
22486 - 28151		7.334068
28152 - 38333		9.520459
38334 or more no trades	15.883147 0.000000	
Number of Accounts with Past Due Balance Amounts Owed	0	0.000000
	1	-7.899614
	2	-15.799228
	3 or more	-35.347687
Number of Accounts with 90-120 Day Late Payments	0	0.000000
	1	6.214122
	2 or more	18.253983
Number of Bank Revolving Accts	1 or more	0.000000
	no bank rev	-12.734985
	no trades	0.000000
Total Amount of High Credit/Credit Limit on Open Department Store Accounts	0 - 99	-0.010197
	100 - 284	-0.494753
	285 - 481	-0.976053
	482 - 715	-1.534430
	716 - 999	-2.199006
	1000 - 1331	-2.979912
	1332 - 1709	-3.913347
	1710 - 2129	-4.977445
	2130 - 2596	-6.100145
	2597 - 3126	-7.386450
	3127 - 3753	-8.881344
(continued on next page)		

**ChoicePoint Attract Standard Auto
Thick File (4 trades or more) Scorecard 2 Specifications**

Description	Interval	Points
Total Amount of High Credit/Credit Limit on Open Department Store Accounts (continued from previous page)	3754 - 4535	-10.692601
	4536 - 5587	-13.049665
	5588 - 7391	-16.529936
	7392 or more	-25.561109
	no dept store	-0.010197
	no trades	0.000000
# of Department Store Accounts with 90-120 Day Late Payments	0	0.000000
	1 or more	-0.816669*value
Average Number of Months Sales Finance Accounts have Been Opened	0 - 9	-0.013647
	10 - 29	-2.158376
	30 - 46	-4.215904
	47 - 61	-5.943301
	62 - 81	-7.768864
	82 or more	-11.761178
	no sales fin	-0.013647
	no trades	0.000000
Number of Retail Accounts	1 or more	0.000000
	no retail	-13.557048
Number of Accounts with Personal Finance Companies	1 or more	0.000000
	no personal fin	19.975297
Number of Auto Finance Accounts	0	0.000000
	1 or more	33.970684
Number of Credit Union, S&L, Mortgage Accts that are Open	0	0.000000
	1	-5.169681
	2	-10.339362
	3 or more	-18.803200
# of Auto Finance Accts with 60 Day Late Payments Ever	0	0.000000
	1 or more	-15.381195*value
Total Number of Months All Accounts have Been Opened	0 - 148	0.375747
	149 - 226	0.722890
	227 - 296	1.004128
	297 - 364	1.267608
	365 - 432	1.528059
	433 - 502	1.793040
	503 - 574	2.064464
	575 - 646	2.340676
	647 - 723	2.626133
	724 - 803	2.926545
	804 - 889	3.243766
	890 - 982	3.587506
	983 - 1083	3.958032
	1084 - 1195	4.365598
	1196 - 1324	4.826319
	1325 - 1476	5.362356
	1477 - 1668	6.014223
	1669 - 1932	6.873851
	1933 - 2369	8.160860
2370 or more	11.437542	
	no trades	0.000000
% of Sales Finance Accts that are Open to Total Accts that are Open on File	0.0000 - 0.0976	-0.225979
	0.0977 - 0.1600	-10.253335
	0.1601 - 9.9992	-23.132310
	no sales fin	-0.225979
	no trades	0.000000
% of Bank Installment Accts that are Open to Total Accts that are Open on File	0.0000 - 0.0690	-0.141733
	0.0691 - 0.1071	-9.302147
	0.1072 - 0.1379	-12.547295
	0.1380 - 0.1613	-15.149280
	0.1614 - 0.2105	-19.335988
	0.2106 - 0.2813	-25.841740
	0.2814 - 0.3889	-34.244910
	0.3890 or more	-62.746359
	no bank instal	-0.141733
	no trades	0.000000

ChoicePoint Attract Standard Auto Thick File (4 trades or more) Scorecard 2 Specifications		
Description	Interval	Points
% of Automotive Related Accts that are Open to Total Accts that are Open on File	0.0000 - 0.0800	-0.109208
	0.0801 - or more	-21.198644
	no auto	-0.109208
	no trades	0.000000
% of Personal Finance Co. Accts that are Open to Total Accts that are Open on File	0.0000 - 0.0882	-0.053629
	0.0883 - 0.1389	-2.639515
	0.1390 - 0.1923	-3.780989
	0.1924 - 0.3226	-5.628208
	0.3227 or more	-12.330008
	no personal fin	-0.053629
% of Oil Company Accts that are open to Total Accts that are Open on File	no trades	0.000000
	0.0000 - 0.0750	-0.273612
	0.0751 - 0.1212	-19.148461
	0.1213 - 0.1944	-29.434720
	0.1945 or more	-58.191688
no oil	-0.273612	
no trades	0.000000	
<u>Score Calculation</u>		
Calculate score 2 for thick files by summing the points assigned above.		
Use six decimal precision for all calculations.		

ChoicePoint Attract Standard Auto
Thick File Loss Ratio Calculation

Instructions:

1. Calculate the Thick File Loss Ratio Score as follows:

$$\text{Thick File Loss Ratio Score} = \text{Thick Score1} / \text{Thick Score2}$$

ChoicePoint Attract Standard Auto
Specifications for Scaling the Thick/Thin Loss Ratio Score to the Final Score

Instructions:

1. After calculating the Thick File Loss Ratio Score or scaling the Thin File Loss Ratio Score, convert the score to the Final Score using formulas provided below. "predlrat" represents the Loss Ratio Score referred to previously. The conditions are mutually exclusive and only one should be used to calculate the Final Score. Round the score to an integer value and cap at 200 and 997.

if (predlrat < 0.006436)	then Final Score =	-122354.751828 *(predlrat - 0.003837) +1147;
if (predlrat < 0.007000)	then Final Score =	-76241.134752 *(predlrat - 0.006436) + 828;
if (predlrat < 0.007495)	then Final Score =	-60606.060606 *(predlrat - 0.007000) + 784;
if (predlrat < 0.008002)	then Final Score =	-51282.051282 *(predlrat - 0.007495) + 753;
if (predlrat < 0.008553)	then Final Score =	-45372.050817 *(predlrat - 0.008002) + 726;
if (predlrat < 0.009169)	then Final Score =	-38961.038961 *(predlrat - 0.008553) + 700;
if (predlrat < 0.009892)	then Final Score =	-35961.272476 *(predlrat - 0.009169) + 675;
if (predlrat < 0.010792)	then Final Score =	-34444.444444 *(predlrat - 0.009892) + 648;
if (predlrat < 0.012209)	then Final Score =	-30345.800988 *(predlrat - 0.010792) + 616;
if (0.012209 <= predlrat)	then Final Score =	-12296.525967 *(predlrat - 0.012209) + 572;

ChoicePoint Attract™ Standard Auto

Description

Number of Derogatory Public Records less Medical Collections

These include Bankruptcy, Lien, Garnishment, Judgment, Suit and items reported by collection agencies excluding collections with a medical industry code.

Number of consumer initiated inquiries in Last 6 Months

Inquiries as a result of the consumer actively seeking to obtain credit. Inquiries from insurance companies are excluded. This does not include inquiries that are as a result of a promotional credit solicitation; these do not appear on the credit file that the insurer receives. Inquiries made as a result of a mortgage or auto loan are each counted as one when made within a 30 day timeframe.

Age of Oldest Account

Using the date open of the account, the total number of months since the oldest account opened.

Number of Accounts with a Balance 75% of Credit Limit

Open accounts are counted if the balance is 75% or greater than the credit limit. An account is considered open if it has a date reported in the last 12 months and has not been reported as closed. Installment accounts must have a balance to be considered open. This does not include mortgage accounts.

Number of Bank Revolving Accounts Currently Paid Satisfactory

The current status is not delinquent (is not rated 2 – 9). A bank revolving account is primarily a Visa or MasterCard type of account.

Number of Sales Finance Accounts with a Balance 75% of Credit Limit

Open Sales finance accounts where the balance divided by the credit limit is 75% or greater. An account is considered open if it has a date reported in the last 12 months and has not been reported as closed. Installment accounts must have a balance to be considered open. A sales finance account is usually associated with high ticket retail items such as furniture, stereo, piano, etc.

Number of Installment Bank Accounts

An installment loan acquired through a bank.

Number of Installment Bank Accts Ever Reported as Bad Debt

Bad Debt refers to an account that is included in bankruptcy, repossession, or a charge off. There is no timeframe associated with when it was reported.

Number of Open Retail Accounts

Retail accounts refer to clothing stores, jewelers, home furnishings, mail order and variety stores. A retail account is considered open if it has been reported in the last 12 months and has not been reported as closed. An installment type retail account must have a balance to be considered open.

Number of Autotmotive Related Accounts with a Past Due Amount

Vehicle related accounts refer to tire dealers, auto parts stores, service stations, and new and used car lots, truck and farm equipment dealers. An amount greater than zero in the past due field of the credit report.

Number of Automotive Related Accts w/30 Day Late Payments Ever

Vehicle related accounts refer to tire dealers, auto parts stores, service stations, and new and used car lots, truck and farm equipment dealers. The account a current status of 2, a previous high rate of 2 or a 30 day counter. The account cannot have any delinquent ratings worse than 30 days. There is no timeframe associated with when it was reported.

Number of Open Automotive Related Accounts

Vehicle related accounts refer to tire dealers, auto parts stores, service stations, and new and used car lots, truck and farm equipment dealers. The account is considered open if it has been reported in the last 12 months. Installment accounts must have a balance greater than zero to be considered open.

Number of Oil Company Accts with 60 Day Late Payments Ever

An oil company account refers to credit cards issued by gas/service stations such as Amoco, BP, etc. The account has a current status of 3, a previous high rate of 3 or a 60 day counter. It cannot have any delinquent ratings worse than 60 days. There is no timeframe associated with when it was reported.

Age of Most Recent Derogatory Public Record excluding medical Collections

These include Bankruptcy (date filed), Lien (date filed), Garnishment (date filed), Judgment & Suit (ate filed), Collections (date reported) excluding collections with a medical industry code.

Number of Inquiries w/Finance Companies Initiated by Consumer in Last 24 Mos

These are inquiries initiated when the consumer is actively seeking to obtain credit from a Auto Finance Company, Credit Union, Sales Finance Company, Mortgage Company, Personal Finance Company, Savings and Loan or Miscellaneous Finance. Auto Finance and Mortgage inquiries are each counted as one when made within a 30 day time frame.

Number of Accounts Opened in Last 24 Months

The number of accounts with a date open in the last 24 months.

Total Amount of Balances owed on Open Accounts

The sum of balances for all open accounts (excluding mortgages). An account is considered open if it has been reported in the last 12 months and has not been reported as closed.

Time Since Most Recent Activity Reported

Using the most recent inquiry date, account date reported, date open or date of last activity, date filed or date reported for derogatory public records. Inquiries from insurance companies are excluded.

Age of Oldest Department Store Account

Using the date open on department store accounts, the number of months since the oldest was open. A department store account is primarily stores such as Penneys, Sears, etc. (These are not included in the "retail account" definition.)

Number of Sales Finance Accounts that are Open

A sales finance account is usually associated with high-ticket retail items such as furniture, stereo, piano, etc. A sales finance account is considered open if it has been reported in the last 12 months and has not been reported as closed. Installment type accounts must have a balance greater than \$0 to be considered open.

Number of Automotive Related Accounts that are Open

Vehicle related accounts refer to tire dealers, auto parts stores, service stations, and new and used car lots, truck and farm equipment dealers. A vehicle related account is considered open if it has been reported in the last 12 months and has not been reported as closed. Installment type accounts must have a balance greater than \$0 to be considered open.

Number of Personal Finance Company Accounts that are Open

A personal finance account is primarily credit institutions such as Household Finance, Beneficial, etc. (most often a more expensive source to obtain credit). A personal finance account is considered open if it has been reported in the last 12 months and has not been reported as closed. Installment type accounts must have a balance greater than \$0 to be considered open.

Number of Oil Company Accounts that are Open

An oil company account refers to credit cards issued by gas/service stations such as Amoco, BP, etc. An account is considered open if it has been reported in the last 12 months and has not been reported as closed. Installment type accounts must have a balance greater than \$0 to be considered open.

Average Debt Burden on Open Bank Revolving Accounts (balance/credit limit)

A bank revolving account is primarily a Visa or MasterCard type of account. The sum of balances divided by the sum of high credits for all open bank revolving accounts. An account is considered open if it has been reported in the last 12 months and has not been reported as closed.

Percent of Accounts reported as satisfactory in Last 24 Months to Total Accounts

Of all accounts on file, the percent of those accounts that have been reported in the last 24 months as always paid as agreed. (satisfactory < 24/total accts on file) A satisfactory account must have a been reported as 1 continually during the 24 months.

Percent of Accounts that are open to Total Accounts on file

Of all accounts on file, the percent of those accounts that are considered open. (open accts/total # accts) An account is considered open if it as been reported in the last 12 months and has not been reported as closed. Installment accounts must have a balance greater than \$0 to be considered open.

Number of Accounts with a Balance reported as satisfactory

The number of accounts with a current status of 0 or 1 (on time) that also have a balance greater than \$0. There is no timeframe associated with this.

Percent of Open Bank Installment Accts to Total Open Accts

Of all the accounts that are considered open, the percent of those accounts that are open installment type accounts with a bank. An account is considered open if it has been reported in the last 12 months and has not been reported as closed. Installment type accounts must have a balance greater than \$0 to be considered open.

Percent of Open Credit Union, S&L or Mortgage Accts to Total Open Accts

Of all accounts that are considered open, the percent of those accounts that is with a credit union, savings and loan or a mortgage company. An account is considered open if it has been reported in the last 12 months and has not been reported as closed. Installment type accounts must have a balance greater than \$0.

Worst Current Rating

Of all accounts on file, the rating which is the worst. Accounts considered with a current rating of 0, 1, 2, 3, 4, 5 or bad debt (charge off, repossession, bankruptcy, financial counseling or foreclosure).

Number of Accounts with 30 Day Late Payments Reported in Last 24 Months

The number of accounts that have been reported as 30 days delinquent (rate 2) in the last 24 months. The account cannot have been reported as worse than 30 days (60 days or worse) in the last 24 months.

Average # of Months Bank Revolving Accounts Have Been Opened

Using the date open on bank revolving accounts calculate the sum of the number of months opened for all bank revolving accounts divided by the number of bank revolving accounts. A bank revolving account is primarily a Visa or MasterCard type of account.

Number of Department Store Accounts

The number of accounts established (regardless of timeframe) with major department stores (primarily Penneys, Sears, etc.).

Number of Department Store Accts with Balance to High Credit of 50% or Greater

The number of accounts with major department stores where the balance divided by the high credit is 50% or greater. The account must be considered open (reported in the past 12 months and not reported as closed. Installment type accounts must have a balance greater than \$0 to be considered open.

Number of Sales Finance Accounts Currently with a 60 Day Late Payment

The current status is rated 3 (60 days past due). The account cannot be worse than 60 days delinquent. A sales finance account is usually associated with high-ticket retail items such as furniture, stereo, piano, etc.

Number of Retail Accounts

The number of accounts established (regardless of timeframe) with retail stores. Retail accounts refer to clothing stores, jewelers, home furnishings, mail order and variety stores.

Number of Auto Finance Accts that are Open

The number of accounts with auto finance companies that are open. An account is considered open if it has been reported in the last 12 months and has not been reported as closed. An auto finance account is primarily associated with GMAC, Ford Motor Credit, etc.

Number of Oil Company Accounts

The number of accounts established (regardless of timeframe) with oil companies. An oil company account refers to credit cards issued by gas/service stations such as Amoco, BP, etc.

Average Debt Burden for Open Sales Finance Accounts

The sum of balances divided by the sum of high credits for all open sales finance accounts. A sales finance account is usually associated with high-ticket retail items such as furniture, stereo, piano, etc. Account is considered open if it has been reported in the last 12 months and has not been reported as closed. Installment type accounts must have a balance greater than \$0 to be considered open.

Percent of Open Bank Revolving Accounts to Total Open Accounts

Of all open accounts on file, the percent of those accounts that are open bank revolving accounts. A bank revolving account is primarily a Visa or MasterCard type of account. An account is considered open if it has been reported in the last 12 months and has not been reported closed.

Number of Collection Agency Filings

Number of items with collection agencies (excluding collections with a medical industry code). These are usually reported in the public record section.

Number of Open Accounts

The number of accounts that are considered open. An account is considered open if it has been reported in the last 12 months and has not been reported closed. Installment type accounts must have a balance greater than \$0 to be considered open.

Number of Accounts with a Past Due Amount

The number of accounts that have an amount greater than \$0 in the past due field. There is no timeframe associated with this.

Number of Accounts with 90 - 120 Day Late Payments Ever

The number of accounts with a 90 day counter, a previous high rate of 4 or 5, or a current status of 4 or 5.

Number of Bank Revolving Accounts

The total number of bank revolving accounts on file. A bank revolving account is primarily a Visa or MasterCard type of account.

Total Credit Limit Amount on Open Department Store Accounts

The sum of credit limits on all open department store accounts. Department Store is an account with a major department store (primarily Penneys, Sears, etc.) An account is considered open if it has been reported in the last 12 months and has not been reported as closed. Installment type accounts must have a balance greater than \$0 to be considered open.

Number of Department Store Accounts Currently with 90 – 120 Day Late Payments

The number of department store accounts with a current status of 4 or 5 regardless of the current date reported. Department Store is an account with a major department store (primarily Penneys, Sears, etc.)

Average Number of Months Sales Finance Accounts have been Established

Using the date open on sales finance accounts. The sum of months sales finance accounts have been opened divided by the number of sales finance accounts on file. A sales finance account is usually associated with high-ticket retail items such as furniture, stereo, piano, etc.

Number of Personal Finance Accounts

The total number of accounts on file established with personal finance companies regardless of timeframe. A personal finance account is primarily credit institutions such as Household Finance, Beneficial, etc.

Number of Auto Finance Accounts

The total number of accounts on file established with a auto finance company regardless of timeframe. This are primarily major car manufacturers such as GMAC, Ford Motor Credit, etc.

Number of Credit Union, S&L or Mortgage Accounts that are Open

The number of accounts with credit unions, savings and loans, and mortgage companies that are considered open. An account is considered open if it has been reported in the last 12 months and has not been reported as closed. Installment type accounts must have a balance greater than \$0 to be considered open

Number of Auto Finance Accts w/60 Day Late Payments Ever

The number of auto finance accounts that have a current status of 3, or a 60 day counter, or a previous high rate of 3. The account can not have any late payments worse than 60 days.

Total Number of Months All Accounts have been Open

Using the date of open for all accounts, the sum of the number of months.

Percent of Open Sales Finance Accounts to Total Open Accounts

Of all accounts that are considered open, the percent of those accounts that are sales finance. An account is considered open if it has been reported in the last 12 months and has not been reported as closed. Installment type accounts must have a balance greater than \$0 to be considered open. A sales finance account is usually associated with high-ticket retail items such as furniture, stereo, piano, etc.

Percent of Open Automotive Related Accounts to Total Open Accounts

Of all accounts that are considered open, the percent of those accounts that are vehicle related. An account is considered open if it has been reported in the last 12 months and has not been reported closed. Installment type accounts must have a balance greater than \$0 to be considered open. Vehicle related accounts refer to tire dealers, auto parts stores, service stations, and new and used car lots, truck and farm equipment dealers.

Percent of Open Personal Finance Accounts to Total Open Accounts

Of all accounts that are considered open, the percent of those accounts that are with personal finance companies. An account is considered open if it has been reported in the last 12 months and has not been reported as closed. Installment type accounts must have a balance greater than \$0 to be considered open. A personal finance account is primarily credit institutions such as Household Finance, Beneficial, etc. (most often a more expensive source to obtain credit).

Percent of Open Oil Company Accounts to Total Open Accounts

Of all accounts that are considered open, the percent of those accounts that are with oil companies. An account is considered open if it has been reported in the last 12 months and has not been reported as closed. Installment type accounts must have a balance greater than \$0 to be considered open. An oil company account refers to credit cards issued by gas/service stations such as Amoco, BP, etc.

**ChoicePoint Attract™
Standard Auto**

Reason Codes and Corresponding Messages

Code	Description:
0101	Number of Derogatory Public Record Items
0102	Number of Inquiries for Transactions Initiated by Consumer in Last 6 Months
0103	Length of Time Accounts have been Established
0105	Number of Accounts with High Percent of Balance to High Credit
0106	Number of Bank Revolving Accounts Currently Paid as Agreed
0107	Number of Sales Finance Accounts with High Percent of Balance to High Credit
0108	Number of Open Installment Bank Accounts
0109	Number of Installment Bank Accts Currently or in the Past Reported as Bad Debt
0110	Number of Retail Accounts Reported in Last 12 Months
0111	Number of Vehicle Related Accounts with a Current Past Due Amount
0112	Number of Vehicle Related Accts Currently or in the Past w/30 Day Late Payment
0113	Number of Open Auto Financing Accounts
0114	Number of Oil Company Accts Currently or in the Past with 60 Day Late Payment
0115	Time Since Most Recent Derogatory Public Record Item
0116	Number of Inquiries w/Finance Companies Initiated by Consumer in Last 24 Mos
0117	Number of Accounts Opened in Last 24 Months
0118	Total Amount of Balances on Accounts
0119	Length of Time Since Most Recent Activity Reported
0120	Length of Time Department Store Accounts have been Established
0121	Number of Sales Finance Accounts Reported in Last 12 Months
0122	Number of Vehicle Related Accounts Reported in Last 12 Months
0123	Number of Personal Finance Company Accounts Reported in Last 12 Mos
0124	Number of Oil Company Accounts Reported in the Last 12 Months
0125	Percent of Balance to High Credit for Bank Revolving Accounts
0126	Percent of Accounts Paid as Agreed in Last 24 Months to Total Accounts
0127	Percent of Accounts Reported in Last 12 Months to Total Accounts
0128	Number of Accounts with a Balance Currently Paid As Agreed
0129	Percent of Open Bank Installment Accts to Total Accts Reported in Last 12 Mos
0130	Percent Credit Union, S&L or Mortgage Accts to Total Accts Rptd in Last 12 Mos
0131	Account with Current Delinquency Reported
0132	Number of Accounts with 30 Day Late Payments Reported in Last 24 Months
0133	Length of Time Bank Revolving Accounts Have Been Established
0134	Number of Department Store Accounts
0135	Number of Department Store Accts with Balance to High Credit of 50% or Greater
0136	Number of Sales Finance Accounts Currently with a 60 Day Late Payment
0137	Number of Retail Accounts
0138	Number of Oil Company Accounts
0139	Percent of Balance to High Credit for Sales Finance Accounts
0140	Percent of Bank Revolving Accounts to Total Accounts Reported in Last 12 Mos
0141	Number of Collection Agency Filings
0142	Number of Accounts Reported in Last 12 Months
0143	Number of Accounts with a Past Due Amount
0144	Number of Accounts Currently or in the Past with 90 - 120 Day Late Payments
0145	Number of Bank Revolving Accounts
0146	Total High Credit Amount on Department Store Accounts
0147	Number of Department Store Accounts Currently with 90 - 120 Day Late Payments
0148	Length of Time Sales Finance Accounts have been Established
0149	Number of Personal Finance Accounts
0150	Number of Credit Union, S&L or Mortgage Accounts Reported in Last 12 Months
0151	Number of Auto Finance Accts Currently or in the Past w/60 Day+ Late Payments
0152	Percent of Sales Finance Accounts to Total Accounts Reported in Last 12 Months
0153	Percent of Vehicle Related Accounts to Total Accounts Reported in Last 12 Mos

0154	Percent of Personal Finance Accounts to Total Accounts Reported in Last 12 Mos
0155	Percent of Oil Company Accounts to Total Accounts Reported in Last 12 Months
0193	Time Since Most Recent Collection Agency Filing Reported
0901	No Public Record Items or Status of Public Record Items is Unknown
0902	Lack of Reported Information on Bank Revolving Accounts
0904	Lack of Reported Information on Bank Installment Accounts
0905	Lack of Reported Information on Credit Union, S&L or Mortgage Accounts
0906	Accounts Currently No More Than 30 Days Late or Status Unknown
0907	Lack of Reported Information on Oil Company Accounts
0908	Lack of Reported Information on Sales Finance Accounts
0909	Lack of Reported Information on Department Store Accounts
0910	Lack of Reported Information on Vehicle Related Accounts
0911	Lack of Reported Information on Personal Finance Accounts

ChoicePoint Attract™ Standard Auto

Description

Number of Derogatory Public Records less Medical Collections

These include Bankruptcy, Lien, Garnishment, Judgment, Suit and items reported by collection agencies excluding collections with a medical industry code.

Number of consumer initiated inquiries in Last 6 Months

Inquiries as a result of the consumer actively seeking to obtain credit. Inquiries from insurance companies are excluded. This does not include inquiries that are as a result of a promotional credit solicitation; these do not appear on the credit file that the insurer receives. Inquiries made as a result of a mortgage or auto loan are each counted as one when made within a 30 day timeframe.

Age of Oldest Account

Using the date open of the account, the total number of months since the oldest account opened.

Number of Accounts with a Balance 75% of Credit Limit

Open accounts are counted if the balance is 75% or greater than the credit limit. An account is considered open if it has a date reported in the last 12 months and has not been reported as closed. Installment accounts must have a balance to be considered open. This does not include mortgage accounts.

Number of Bank Revolving Accounts Currently Paid Satisfactory

The current status is not delinquent (is not rated 2 – 9). A bank revolving account is primarily a Visa or MasterCard type of account.

Number of Sales Finance Accounts with a Balance 75% of Credit Limit

Open Sales finance accounts where the balance divided by the credit limit is 75% or greater. An account is considered open if it has a date reported in the last 12 months and has not been reported as closed. Installment accounts must have a balance to be considered open. A sales finance account is usually associated with high ticket retail items such as furniture, stereo, piano, etc.

Number of Installment Bank Accounts

An installment loan acquired through a bank.

**ASSIST 2.0, a Fair, Isaac Insurance Score
Non-Standard Auto Scorecard - ASSIST 2.0 TX NS 1003**

The ASSIST NS score is calculated in 3 steps.

- 1) determine the points for each characteristic below
- 2) sum the points from step 1
- 3) multiply the sum in step 2 by 1.2446 and subtract 178

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Average Months in File of all Accounts		
	0-20	0
	21-23	2
	24-29	9
	30-32	17
	33-39	19
	40-41	21
	42-47	23
	48-53	37
	54-59	44
	60-65	47
	66-71	49
	72-83	54
	84-89	56
	90-95	58
	96-105	59
	106-115	61
	116-119	63
	120-139	65
	140-159	66
	160-179	68
	180-199	70
	200-219	72
	220-239	73
	240-359	75
	360-479	77
	480-599	79
	600-9999	80
Months Since Last Delinquency		
	0-2	32
	3-5	33
	6-8	47
	9-11	58
	12-17	64
	18-23	70
	24-35	72
	36-47	73
	48-9999	76
	no delinquency	78

**ASSIST 2.0, a Fair, Isaac Insurance Score
Non-Standard Auto Scorecard - ASSIST 2.0 TX NS 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number of Inquiries in the Last Year	0	6
	1	5
	2	4
	3	2
	4	1
	5-999	0
Months Since Oldest Date Opened	0-47	0
	48-95	3
	96-107	6
	108-119	9
	120-143	12
	144-161	14
	162-179	17
	180-209	20
	210-239	23
	240-263	26
	264-287	29
	288-319	32
	320-359	35
	360-499	38
500-9999	40	
Worst Delinquency in the Last Year	60 days or more delinquent	32
	30 days delinquent	33
	prior to this last year, a 60 day or undatable delinquency	35
	prior to this last year, a 30 delinquency	38
	never delinquent	43
	all other	40
Months Since Most Recent Public Record	0-7	96
	8-11	97
	12-23	98
	24-35	99
	36-9999	106
	no public record	134

**ASSIST 2.0, a Fair, Isaac Insurance Score
Non-Standard Auto Scorecard - ASSIST 2.0 TX NS 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Months Since Most Recent Collection		
	0-23	64
	24-59	66
	60-9999	74
	no collection	103
Number of Public Records		
	0	106
	1	103
	2	101
	3	98
	4-999	96
Number of Collections		
	0	74
	1	72
	2	69
	3	66
	4-999	64
Number of Accounts in Default Status		
	0	76
	1	65
	2	54
	3	43
	4-999	32
Number Accounts Where Balance is 75% of Limit		
	0	85
	1	59
	2	30
	3	13
	4-999	0
	all other	58
Number of Finance Company Accounts		
	0-1	2
	2-4	1
	5-999	0

**ASSIST 2.0 - A Fair, Isaac Insurance Score
Standard Auto Greater Than Minimum Limits - ASSIST 2.0 TX SG 1003**

The ASSIST 2.0 SG score is calculated in 2 steps.
 1) determine the points for each characteristic below
 2) sum the points from step 1 to calculate the final score

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Average Months in File of all Accounts		
	0-20	0
	21-23	1
	24-29	6
	30-32	12
	33-39	13
	40-41	15
	42-47	16
	48-53	26
	54-59	31
	60-65	33
	66-71	34
	72-83	38
	84-89	39
	90-95	40
	96-105	42
	106-115	43
	116-119	44
	120-139	45
	140-159	47
	160-179	48
	180-199	49
	200-219	50
	220-239	51
	240-359	53
	360-479	54
	480-599	55
	600-9999	56
Months Since Last Delinquency		
	0-2	34
	3-5	35
	6-8	46
	9-11	54
	12-17	58
	18-23	63
	24-35	65
	36-47	66
	48-9999	68
	no delinquency	70

**ASSIST 2.0 - A Fair, Isaac Insurance Score
Standard Auto Greater Than Minimum Limits - ASSIST 2.0 TX SG 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number of Inquiries in the Last Year	0	9
	1	8
	2	6
	3	4
	4	1
	5-999	0
Months Since Oldest Date Opened	0-47	0
	48-95	1
	96-107	3
	108-119	4
	120-143	6
	144-161	7
	162-179	8
	180-209	10
	210-239	11
	240-263	13
	264-287	14
	288-319	15
	320-359	17
	360-499	18
500-9999	20	
Worst Delinquency in the Last Year	90 days or more delinquent	34
	60 days delinquent	35
	30 days delinquent	36
	prior to this last year, a 60 day or undatable delinquency	42
	prior to this last year, a 30 delinquency	49
	never delinquent	62
	all other	53
Months Since Most Recent Public Record	0-7	101
	8-11	102
	12-23	102
	24-35	103
	36-9999	107
	no public record	125

**ASSIST 2.0 - A Fair, Isaac Insurance Score
Standard Auto Greater Than Minimum Limits - ASSIST 2.0 TX SG 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Months Since Most Recent Collection	0-11	67
	12-23	68
	24-59	69
	60-9999	73
	no collection	91
Number of Public Records	0	107
	1	105
	2	104
	3	102
	4-999	101
Number of Collections	0	73
	1	72
	2	70
	3	69
	4-999	67
Number of Accounts in Default Status	0	47
	1	44
	2	41
	3	37
	4-999	34
Number Accounts Where Balance is 75% of Limit	0	50
	1	35
	2	17
	3	8
	4-999	0
	all other	34
Number of Finance Company Accounts	0	26
	1	21
	2	18
	3	16
	4	13
	5-999	0

**ASSIST 2.0 - A Fair, Isaac Insurance Score
Standard Auto Greater Than Minimum Limits - ASSIST 2.0 TX SG 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number of Accounts 90+ days Delinquent Ever		
	0	26
	1	11
	2	9
	3	6
	4	3
	5-999	0
Number of Accounts 60+ days Delinquent in Last 2 Years		
	0	25
	1	10
	2	7
	3	5
	4	2
	5-999	0

ASSIST 2.0 - A Fair, Isaac Insurance Score Preferred Auto Minimum Limits - ASSIST 2.0 TX PM 1003

The ASSIST 2.0 PM score is calculated in 4 steps.

- 1) determine the points for each characteristic below
- 2) sum the points from step 1
- 3) add 244 to the sum from step 2
- 4) if the sum from step 3 is 725 or higher, multiply by 1.5 and subtract 363
 else if the sum from step 3 is 625 through 724, then multiply by 1.2 and subtract 146
 otherwise, the sum in step 3 is the final score

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Average Months in File of all Accounts		
	0-20	0
	21-23	1
	24-29	5
	30-32	11
	33-39	12
	40-41	13
	42-47	14
	48-53	22
	54-59	26
	60-65	28
	66-71	29
	72-83	33
	84-89	34
	90-95	35
	96-105	36
	106-115	37
	116-119	38
	120-139	39
	140-159	40
	160-179	41
	180-199	42
	200-219	43
	220-239	44
	240-359	45
	360-479	46
	480-599	47
	600-9999	48
Month Since Last Delinquency		
	0-2	41
	3-5	42
	6-8	60
	9-11	73
	12-17	81
	18-23	88
	24-35	91
	36-47	93
	48-9999	96
	no delinquency	99

ASSIST 2.0 - A Fair, Isaac Insurance Score
Preferred Auto Minimum Limits - ASSIST 2.0 TX PM 1003 (cont.)

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number of Inquiries in the Last Year	0	56
	1	49
	2	37
	3	22
	4	6
	5-999	0
Worst Delinquency in the Last Year	30 days or more delinquent	41
	prior to this last year, a 60 day or undatable delinquency	43
	prior to this last year, a 30 delinquency	45
	never delinquent	48
	all other	46
Number of Public Records	0	70
	1-3	0
	4-999	0
Number of Collections	0	60
	1-3	0
	4-999	0
Number Accounts Where Balance is 75% of Limit	0	25
	1	17
	2	9
	3	4
	4-999	0
	all other	14

**ASSIST 2.0 - A Fair, Isaac Insurance Score
Preferred Auto Minimum Limits - ASSIST 2.0 TX PM 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Percent of Current Balance to Limit on Revolving Accounts		
	0	60
	1-4	77
	5-9	73
	10-14	64
	15-19	60
	20-29	51
	30-34	45
	35-39	44
	40-49	38
	50-59	30
	60-69	26
	70-79	24
	80-89	9
	90-100	2
	101-999	0
	all other	38
 Number of National Bank Accounts		
	0	20
	1	20
	2	25
	3	23
	4	20
	5	18
	6	15
	7	13
	8	10
	9-999	0
 Number of Accounts 90+ days Delinquent Ever		
	0	40
	1-999	0
 Number of Accounts 60+ days Delinquent in Last 2 Years		
	0	13
	1	10
	2	8
	3	5
	4	3
	5-999	0

**ASSIST 2.0, a Fair, Isaac Insurance Score
Preferred Auto Greater Than Minimum Limits - ASSIST 2.0 TX PG 1003**

The ASSIST 2.0 PG score is calculated in 4 steps.

- 1) determine the points for each characteristic below
- 2) sum the points from step 1
- 3) add 150 to the sum from step 2
- 4) if the sum from step 3 is less than 730, multiply by 1.0833 and subtract 65
otherwise, multiply by 2.44 and subtract 1066

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Average Months in File of all Accounts		
	0-20	0
	21-23	2
	24-29	8
	30-32	16
	33-39	18
	40-41	20
	42-47	21
	48-53	34
	54-59	41
	60-65	44
	66-71	46
	72-83	51
	84-89	52
	90-95	54
	96-105	56
	106-115	57
	116-119	59
	120-139	60
	140-159	62
	160-179	64
	180-199	65
	200-219	67
	220-239	69
	240-359	70
	360-479	72
	480-599	73
	600-9999	75
Months Since Last Delinquency		
	0-2	30
	3-5	31
	6-8	41
	9-11	48
	12-17	53
	18-23	57
	24-35	58
	36-47	59
	48-9999	61
	no delinquency	63

**ASSIST 2.0, a Fair, Isaac Insurance Score
Preferred Auto Greater Than Minimum Limits - ASSIST 2.0 TX PG 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number of Inquiries in the Last Year	0	58
	1	51
	2	39
	3	23
	4	6
	5-999	0
Worst Delinquency in the Last Year	90 days or more delinquent	30
	60 days delinquent	32
	30 days delinquent	33
	prior to this last year, a 60 day or undatable delinquency	41
	prior to this last year, a 30 delinquency	50
	never delinquent	66
	all other	56
Months Since Most Recent Public Record	0-7	90
	8-11	91
	12-23	92
	24-35	92
	36-9999	96
	no public record	112
	Months Since Most Recent Collection	0-11	60
12-23		61
24-59		61
60-9999		66
no collection		81
Number of Accounts in Default Status		0	37
	1	35
	2	33
	3	32
	4-999	30

**ASSIST 2.0, a Fair, Isaac Insurance Score
Preferred Auto Greater Than Minimum Limits - ASSIST 2.0 TX PG 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number Accounts Where Balance is 75% of Limit	0	32
	1	22
	2	11
	3	5
	4-999	0
	all other	21
Number of Finance Company Accounts	0	28
	1	22
	2	19
	3	17
	4	14
	5-999	0
	all other	14
Number of National Bank Accounts	0	7
	1	7
	2	8
	3	7
	4	7
	5	6
	6	5
	7	4
	8	3
	9-999	0
Number of Accounts 90+ days Delinquent Ever	0	27
	1	18
	2	13
	3	9
	4	4
	5-999	0
Number of Accounts 60+ days Delinquent in Last 2 Years	0	35
	1	22
	2	16
	3	11
	4	5
	5-999	0

ASSIST 2.0 - A Fair, Isaac Insurance Score
Standard Auto Minimum Limits - ASSIST 2.0 TX SM 1003

The ASSIST 2.0 SM score is calculated in 4 steps.

- 1) determine the points for each characteristic below
- 2) sum the points from step 1
- 3) add 75 to the sum from step 2
- 4) if the sum from step 3 is less than 694, multiply by 1.076 and subtract 53
 otherwise multiply by 1.328 and subtract 228

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Average Months in File of all Accounts		
	0-20	0
	21-23	1
	24-29	7
	30-32	14
	33-39	16
	40-41	17
	42-47	19
	48-53	30
	54-59	36
	60-65	39
	66-71	40
	72-83	45
	84-89	46
	90-95	47
	96-105	49
	106-115	50
	116-119	52
	120-139	53
	140-159	55
	160-179	56
	180-199	58
	200-219	59
	220-239	60
	240-359	62
	360-479	63
	480-599	65
	600-9999	66
Month Since Last Delinquency		
	0-2	25
	3-5	26
	6-8	35
	9-11	42
	12-17	45
	18-23	49
	24-35	50
	36-47	51
	48-9999	53
	no delinquency	54

**ASSIST 2.0 - A Fair, Isaac Insurance Score
Standard Auto Minimum Limits - ASSIST 2.0 TX SM 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number of Inquiries in the Last Year	0	71
	1	63
	2	47
	3	28
	4	8
	5-999	0
Months Since Oldest Date Opened	0-95	0
	96-119	1
	120-161	2
	162-209	3
	210-263	4
	264-359	5
	360-9999	6
Worst Delinquency in the Last Year	90 days or more delinquent	25
	60 days delinquent	27
	30 days delinquent	28
	prior to this last year, a 60 day or undatable delinquency	36
	prior to this last year, a 30 delinquency	45
	never delinquent	62
	all other	51
Months Since Most Recent Public Record	0-7	75
	8-11	78
	12-23	79
	24-35	80
	36-9999	92
	no public record	136
Months Since Most Recent Collection	0-11	50
	12-23	51
	24-59	54
	60-9999	66
	no collection	111

**ASSIST 2.0 - A Fair, Isaac Insurance Score
Standard Auto Minimum Limits - ASSIST 2.0 TX SM 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number of Collections	0	55
	1	54
	2	53
	3	51
	4-999	50
Number of Accounts in Default Status	0	45
	1	40
	2	35
	3	30
	4-999	25
Number Accounts Where Balance is 75% of Limit	0	29
	1	20
	2	10
	3	4
	4-999	0
	all other	17
Number of Finance Company Accounts	0	15
	1	12
	2	10
	3	9
	4	7
	5-999	0
Number of Accounts 90+ days Delinquent Ever	0	24
	1	5
	2	3
	3	2
	4	1
	5-999	0
Number of Accounts 60+ days Delinquent in Last 2 Years	0	30
	1	18
	2	14
	3	9
	4	5
	5-999	0

**ASSIST 2.0, a Fair, Isaac Insurance Score
Non-Standard Auto Scorecard - ASSIST 2.0 TX NS 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number of National Bank Accounts		
	0	5
	1	5
	2	7
	3	6
	4-5	5
	6	4
	7-8	3
	9-999	0
Number of Accounts 90+ days Delinquent Ever		
	0	29
	1-4	0
	5-999	0
Number of Accounts 60+ days Delinquent in Last 2 Years		
	0	15
	1-4	0
	5-999	0

**ASSIST 2.0, a Fair, Isaac Insurance Score
Non-Standard Auto Scorecard - ASSIST 2.0 TX NS 1003**

The ASSIST NS score is calculated in 3 steps.

- 1) determine the points for each characteristic below
- 2) sum the points from step 1
- 3) multiply the sum in step 2 by 1.2446 and subtract 178

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Average Months in File of all Accounts		
	0-20	0
	21-23	2
	24-29	9
	30-32	17
	33-39	19
	40-41	21
	42-47	23
	48-53	37
	54-59	44
	60-65	47
	66-71	49
	72-83	54
	84-89	56
	90-95	58
	96-105	59
	106-115	61
	116-119	63
	120-139	65
	140-159	66
	160-179	68
	180-199	70
	200-219	72
	220-239	73
	240-359	75
	360-479	77
	480-599	79
	600-9999	80
Months Since Last Delinquency		
	0-2	32
	3-5	33
	6-8	47
	9-11	58
	12-17	64
	18-23	70
	24-35	72
	36-47	73
	48-9999	76
	no delinquency	78

**ASSIST 2.0, a Fair, Isaac Insurance Score
Non-Standard Auto Scorecard - ASSIST 2.0 TX NS 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number of Inquiries in the Last Year	0	6
	1	5
	2	4
	3	2
	4	1
	5-999	0
Months Since Oldest Date Opened	0-47	0
	48-95	3
	96-107	6
	108-119	9
	120-143	12
	144-161	14
	162-179	17
	180-209	20
	210-239	23
	240-263	26
	264-287	29
	288-319	32
	320-359	35
	360-499	38
500-9999	40	
Worst Delinquency in the Last Year	60 days or more delinquent	32
	30 days delinquent	33
	prior to this last year, a 60 day or undatable delinquency	35
	prior to this last year, a 30 delinquency	38
	never delinquent	43
	all other	40
Months Since Most Recent Public Record	0-7	96
	8-11	97
	12-23	98
	24-35	99
	36-9999	106
	no public record	134

**ASSIST 2.0, a Fair, Isaac Insurance Score
Non-Standard Auto Scorecard - ASSIST 2.0 TX NS 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Months Since Most Recent Collection		
	0-23	64
	24-59	66
	60-9999	74
	no collection	103
Number of Public Records		
	0	106
	1	103
	2	101
	3	98
	4-999	96
Number of Collections		
	0	74
	1	72
	2	69
	3	66
	4-999	64
Number of Accounts in Default Status		
	0	76
	1	65
	2	54
	3	43
	4-999	32
Number Accounts Where Balance is 75% of Limit		
	0	85
	1	59
	2	30
	3	13
	4-999	0
	all other	58
Number of Finance Company Accounts		
	0-1	2
	2-4	1
	5-999	0

**ASSIST 2.0 - A Fair, Isaac Insurance Score
Standard Auto Greater Than Minimum Limits - ASSIST 2.0 TX SG 1003**

The ASSIST 2.0 SG score is calculated in 2 steps.
 1) determine the points for each characteristic below
 2) sum the points from step 1 to calculate the final score

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Average Months in File of all Accounts		
	0-20	0
	21-23	1
	24-29	6
	30-32	12
	33-39	13
	40-41	15
	42-47	16
	48-53	26
	54-59	31
	60-65	33
	66-71	34
	72-83	38
	84-89	39
	90-95	40
	96-105	42
	106-115	43
	116-119	44
	120-139	45
	140-159	47
	160-179	48
	180-199	49
	200-219	50
	220-239	51
	240-359	53
	360-479	54
	480-599	55
	600-9999	56
Months Since Last Delinquency		
	0-2	34
	3-5	35
	6-8	46
	9-11	54
	12-17	58
	18-23	63
	24-35	65
	36-47	66
	48-9999	68
	no delinquency	70

**ASSIST 2.0 - A Fair, Isaac Insurance Score
Standard Auto Greater Than Minimum Limits - ASSIST 2.0 TX SG 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number of Inquiries in the Last Year	0	9
	1	8
	2	6
	3	4
	4	1
	5-999	0
Months Since Oldest Date Opened	0-47	0
	48-95	1
	96-107	3
	108-119	4
	120-143	6
	144-161	7
	162-179	8
	180-209	10
	210-239	11
	240-263	13
	264-287	14
	288-319	15
	320-359	17
	360-499	18
500-9999	20	
Worst Delinquency in the Last Year	90 days or more delinquent	34
	60 days delinquent	35
	30 days delinquent	36
	prior to this last year, a 60 day or undatable delinquency	42
	prior to this last year, a 30 delinquency	49
	never delinquent	62
	all other	53
Months Since Most Recent Public Record	0-7	101
	8-11	102
	12-23	102
	24-35	103
	36-9999	107
	no public record	125

ASSIST 2.0 - A Fair, Isaac Insurance Score
Standard Auto Greater Than Minimum Limits - ASSIST 2.0 TX SG 1003 (cont.)

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Months Since Most Recent Collection	0-11	67
	12-23	68
	24-59	69
	60-9999	73
	no collection	91
Number of Public Records	0	107
	1	105
	2	104
	3	102
	4-999	101
Number of Collections	0	73
	1	72
	2	70
	3	69
	4-999	67
Number of Accounts in Default Status	0	47
	1	44
	2	41
	3	37
	4-999	34
Number Accounts Where Balance is 75% of Limit	0	50
	1	35
	2	17
	3	8
	4-999	0
	all other	34
Number of Finance Company Accounts	0	26
	1	21
	2	18
	3	16
	4	13
	5-999	0

ASSIST 2.0 - A Fair, Isaac Insurance Score
Standard Auto Greater Than Minimum Limits - ASSIST 2.0 TX SG 1003 (cont.)

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number of Accounts 90+ days Delinquent Ever		
	0	26
	1	11
	2	9
	3	6
	4	3
	5-999	0
Number of Accounts 60+ days Delinquent in Last 2 Years		
	0	25
	1	10
	2	7
	3	5
	4	2
	5-999	0

**ASSIST 2.0 - A Fair, Isaac Insurance Score
Preferred Auto Minimum Limits - ASSIST 2.0 TX PM 1003**

The ASSIST 2.0 PM score is calculated in 4 steps.

- 1) determine the points for each characteristic below
- 2) sum the points from step 1
- 3) add 244 to the sum from step 2
- 4) if the sum from step 3 is 725 or higher, multiply by 1.5 and subtract 363
 else if the sum from step 3 is 625 through 724, then multiply by 1.2 and subtract 146
 otherwise, the sum in step 3 is the final score

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Average Months in File of all Accounts		
	0-20	0
	21-23	1
	24-29	5
	30-32	11
	33-39	12
	40-41	13
	42-47	14
	48-53	22
	54-59	26
	60-65	28
	66-71	29
	72-83	33
	84-89	34
	90-95	35
	96-105	36
	106-115	37
	116-119	38
	120-139	39
	140-159	40
	160-179	41
	180-199	42
	200-219	43
	220-239	44
	240-359	45
	360-479	46
	480-599	47
	600-9999	48
Month Since Last Delinquency		
	0-2	41
	3-5	42
	6-8	60
	9-11	73
	12-17	81
	18-23	88
	24-35	91
	36-47	93
	48-9999	96
	no delinquency	99

ASSIST 2.0 - A Fair, Isaac Insurance Score
Preferred Auto Minimum Limits - ASSIST 2.0 TX PM 1003 (cont.)

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number of Inquiries in the Last Year	0	56
	1	49
	2	37
	3	22
	4	6
	5-999	0
Worst Delinquency in the Last Year	30 days or more delinquent	41
	prior to this last year, a 60 day or undatable delinquency	43
	prior to this last year, a 30 delinquency	45
	never delinquent	48
	all other	46
Number of Public Records	0	70
	1-3	0
	4-999	0
Number of Collections	0	60
	1-3	0
	4-999	0
Number Accounts Where Balance is 75% of Limit	0	25
	1	17
	2	9
	3	4
	4-999	0
	all other	14

ASSIST 2.0 - A Fair, Isaac Insurance Score
Preferred Auto Minimum Limits - ASSIST 2.0 TX PM 1003 (cont.)

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Percent of Current Balance to Limit on Revolving Accounts		
	0	60
	1-4	77
	5-9	73
	10-14	64
	15-19	60
	20-29	51
	30-34	45
	35-39	44
	40-49	38
	50-59	30
	60-69	26
	70-79	24
	80-89	9
	90-100	2
	101-999	0
	all other	38
Number of National Bank Accounts		
	0	20
	1	20
	2	25
	3	23
	4	20
	5	18
	6	15
	7	13
	8	10
	9-999	0
Number of Accounts 90+ days Delinquent Ever		
	0	40
	1-999	0
Number of Accounts 60+ days Delinquent in Last 2 Years		
	0	13
	1	10
	2	8
	3	5
	4	3
	5-999	0

**ASSIST 2.0, a Fair, Isaac Insurance Score
Preferred Auto Greater Than Minimum Limits - ASSIST 2.0 TX PG 1003**

The ASSIST 2.0 PG score is calculated in 4 steps.

- 1) determine the points for each characteristic below
- 2) sum the points from step 1
- 3) add 150 to the sum from step 2
- 4) if the sum from step 3 is less than 730, multiply by 1.0833 and subtract 65
otherwise, multiply by 2.44 and subtract 1066

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Average Months in File of all Accounts		
	0-20	0
	21-23	2
	24-29	8
	30-32	16
	33-39	18
	40-41	20
	42-47	21
	48-53	34
	54-59	41
	60-65	44
	66-71	46
	72-83	51
	84-89	52
	90-95	54
	96-105	56
	106-115	57
	116-119	59
	120-139	60
	140-159	62
	160-179	64
	180-199	65
	200-219	67
	220-239	69
	240-359	70
	360-479	72
	480-599	73
	600-9999	75
Months Since Last Delinquency		
	0-2	30
	3-5	31
	6-8	41
	9-11	48
	12-17	53
	18-23	57
	24-35	58
	36-47	59
	48-9999	61
	no delinquency	63

**ASSIST 2.0, a Fair, Isaac Insurance Score
Preferred Auto Greater Than Minimum Limits - ASSIST 2.0 TX PG 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number of Inquiries in the Last Year	0	58
	1	51
	2	39
	3	23
	4	6
	5-999	0
Worst Delinquency in the Last Year	90 days or more delinquent	30
	60 days delinquent	32
	30 days delinquent	33
	prior to this last year, a 60 day or undatable delinquency	41
	prior to this last year, a 30 delinquency	50
	never delinquent	66
	all other	56
Months Since Most Recent Public Record	0-7	90
	8-11	91
	12-23	92
	24-35	92
	36-9999	96
	no public record	112
	Months Since Most Recent Collection	0-11	60
12-23		61
24-59		61
60-9999		66
no collection		81
Number of Accounts in Default Status		0	37
	1	35
	2	33
	3	32
	4-999	30

**ASSIST 2.0, a Fair, Isaac Insurance Score
Preferred Auto Greater Than Minimum Limits - ASSIST 2.0 TX PG 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number Accounts Where Balance is 75% of Limit	0	32
	1	22
	2	11
	3	5
	4-999	0
	all other	21
Number of Finance Company Accounts	0	28
	1	22
	2	19
	3	17
	4	14
	5-999	0
	all other	14
Number of National Bank Accounts	0	7
	1	7
	2	8
	3	7
	4	7
	5	6
	6	5
	7	4
	8	3
	9-999	0
Number of Accounts 90+ days Delinquent Ever	0	27
	1	18
	2	13
	3	9
	4	4
	5-999	0
Number of Accounts 60+ days Delinquent in Last 2 Years	0	35
	1	22
	2	16
	3	11
	4	5
	5-999	0

ASSIST 2.0 - A Fair, Isaac Insurance Score
Standard Auto Minimum Limits - ASSIST 2.0 TX SM 1003

The ASSIST 2.0 SM score is calculated in 4 steps.

- 1) determine the points for each characteristic below
- 2) sum the points from step 1
- 3) add 75 to the sum from step 2
- 4) if the sum from step 3 is less than 694, multiply by 1.076 and subtract 53
 otherwise multiply by 1.328 and subtract 228

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Average Months in File of all Accounts		
	0-20	0
	21-23	1
	24-29	7
	30-32	14
	33-39	16
	40-41	17
	42-47	19
	48-53	30
	54-59	36
	60-65	39
	66-71	40
	72-83	45
	84-89	46
	90-95	47
	96-105	49
	106-115	50
	116-119	52
	120-139	53
	140-159	55
	160-179	56
	180-199	58
	200-219	59
	220-239	60
	240-359	62
	360-479	63
	480-599	65
	600-9999	66
Month Since Last Delinquency		
	0-2	25
	3-5	26
	6-8	35
	9-11	42
	12-17	45
	18-23	49
	24-35	50
	36-47	51
	48-9999	53
	no delinquency	54

**ASSIST 2.0 - A Fair, Isaac Insurance Score
Standard Auto Minimum Limits - ASSIST 2.0 TX SM 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number of Inquiries in the Last Year	0	71
	1	63
	2	47
	3	28
	4	8
	5-999	0
Months Since Oldest Date Opened	0-95	0
	96-119	1
	120-161	2
	162-209	3
	210-263	4
	264-359	5
	360-9999	6
Worst Delinquency in the Last Year	90 days or more delinquent	25
	60 days delinquent	27
	30 days delinquent	28
	prior to this last year, a 60 day or undatable delinquency	36
	prior to this last year, a 30 delinquency	45
	never delinquent	62
	all other	51
Months Since Most Recent Public Record	0-7	75
	8-11	78
	12-23	79
	24-35	80
	36-9999	92
	no public record	136
Months Since Most Recent Collection	0-11	50
	12-23	51
	24-59	54
	60-9999	66
	no collection	111

**ASSIST 2.0 - A Fair, Isaac Insurance Score
Standard Auto Minimum Limits - ASSIST 2.0 TX SM 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number of Collections	0	55
	1	54
	2	53
	3	51
	4-999	50
Number of Accounts in Default Status	0	45
	1	40
	2	35
	3	30
	4-999	25
Number Accounts Where Balance is 75% of Limit	0	29
	1	20
	2	10
	3	4
	4-999	0
	all other	17
Number of Finance Company Accounts	0	15
	1	12
	2	10
	3	9
	4	7
	5-999	0
Number of Accounts 90+ days Delinquent Ever	0	24
	1	5
	2	3
	3	2
	4	1
	5-999	0
Number of Accounts 60+ days Delinquent in Last 2 Years	0	30
	1	18
	2	14
	3	9
	4	5
	5-999	0

**ASSIST 2.0, a Fair, Isaac Insurance Score
Non-Standard Auto Scorecard - ASSIST 2.0 TX NS 1003 (cont.)**

<u>Characteristic</u>	<u>Attribute</u>	<u>Weight</u>
Number of National Bank Accounts		
	0	5
	1	5
	2	7
	3	6
	4-5	5
	6	4
	7-8	3
	9-999	0
Number of Accounts 90+ days Delinquent Ever		
	0	29
	1-4	0
	5-999	0
Number of Accounts 60+ days Delinquent in Last 2 Years		
	0	15
	1-4	0
	5-999	0

**Birny Birnbaum
Center for Economic Justice**

NAIC Hearing on Insurance Credit Scoring

April 30, 2009

Actuarial Considerations

The Role of Risk Classifications in the Insurance System

Risk classifications are any factor used by an insurer to segment the population for purposes of determining whether to offer insurance, what terms and products to offer and what price to offer, whether that is called underwriting, tier placement or rating.

What is role of risk classification? Why not one average rate for everyone -- why not average rates for everyone?

1. Protect insurer financial condition by preventing or limiting adverse selection
2. Promote loss prevention / loss mitigation
3. Fairness in pricing -- group consumers of similar risk for purposes of assigning premium
4. Fairness in pricing -- rates based on characteristics society deems fair

Some risk classification is essential to prevent adverse selection, to provide incentives for loss prevention and meet basic **societal** standards of fairness and equity..

Revolution in Risk Classification

In recent years, risk classification has become more and more detailed, with more and more rate levels, more rating factors and more categories within rating factors. As risk classification becomes more and more detailed, the spread of prices increase as the cost for the most desirable policyholder goes down and the cost for the most undesirable policyholder goes up.

This has profound implication for the affordability of insurance because, inevitably, those consumers least able to afford insurance are the least desirable consumers for insurers and the ones facing higher and higher prices because of ultra risk classification.

Risk classification taken to the extreme is the end of insurance – a pay-as-you-go system in which those who pose no risk pay little or nothing and those who have a claim pay the cost of the claim.

Insurance credit scoring was the beginning of this revolution in risk classification because it was a massive database on a huge number of consumers that lent itself to the data mining necessary for refined risk classifications. That data mining / risk classification process has moved on to other consumer databases and other questionable risk classifications: education, occupation, prior liability limits, household composition, property-specific catastrophe and geographic rating, policy inquiries and surely others we do not know about.

Correlation Necessary, But Not Sufficient to Justify a Risk Classification

The fact that a characteristic of the consumer, vehicle or property is associated with a difference in expenses or expected losses is a necessary, **but not sufficient**, justification for use as a risk classification.

For actuaries, the definition of fair or equitable is simply a difference in expected costs: Rates within a risk classification system would be considered equitable if differences in rates reflect material differences in expected cost for risk characteristics. In the context of rates, the word *fair* is often used in place of the word *equitable*.¹

While this may be a sufficient definition of fair for insurers and actuaries, it is not sufficient for meeting public policy goals of insurance.

Just because insurers can find a characteristic that is correlated with expenses or expected losses does not mean that characteristic should or must be used.

Insurers themselves ignore or downplay risk factors demonstrably related to expected losses for their own business purposes – miles driven is a prime example – and yet the insurance system has not collapsed.

Insurers argue that failure to use insurance scoring will result in “low risk” consumers subsidizing “high risk” consumers.

The purpose of insurance is to pool risks – those with claims are subsidized by those without claims. The purpose of insurance is not to allocate costs to those who generate the costs, but to spread the risk and the costs across a pool of consumers. This is what makes it insurance and not a pay-as-you-go system.

¹ ASOP 12, 2005 Edition, Section 3.2.1. The original ASOP on Risk Classification, issued in 1989, Section 2.4, defined “Equitable or Fair—Appropriately reflecting differences among the costs of identifiable risk characteristics. The two terms are used interchangeably in this standard.”

Certain characteristics are not permitted – race, religion, national origin and in some states, marital status, credit information or being an elected official. They are not permitted because society does not believe these are proper bases for charging different insurance premiums – regardless of whether these characteristics are correlated with claims. We don't allow race-based life insurance premiums even though there is evidence that African Americans have shorter life expectancies than White Americans.

While we will argue that insurance scoring violates public policy and should be banned for that reason, it is clear that insurers' use of insurance scoring is not necessary, one, to protect insurer financial condition by preventing adverse selection, and two, to create a fair risk classification system.

It is not necessary because sufficient risk classification exists to protect insurer financial condition and prevent adverse selection. Insurance scoring not only does not prevent adverse selection – most consumers do not know that their credit information is used for underwriting or rating insurance – insurance scoring lends itself to adverse selection because it invites consumers to manipulate their credit score. The evidence of this is that there are no problems associated with the absence of credit scoring to be found in those states which ban credit scoring. In fact, insurers tout the new Massachusetts auto insurance regulatory regime – Progressive and GEICO have recently entered the market – despite a ban on insurance scoring. There are no problems in the California auto or Maryland homeowners markets attributable to these states' prohibition on insurance scoring.

Insurance scoring is not necessary to create a fair insurance system. A ban on insurance scoring does not prohibit insurers from using risk classifications that consumers understand and respond to for purpose of loss mitigation, like driving record, anti-theft devices, type of vehicle, catastrophe-resistant construction and many others.

Further, insurance scoring should be banned because it undermines the vital loss mitigation role of insurance. Insurance scoring provides no economic incentives for changing risky behavior; only economic signals to manipulate a credit report.

But beyond this, insurance scoring should be prohibited on purely actuarial grounds as unfairly discriminatory in the actuarial sense and in violation of actuarial standards of practice.

Insurance Scoring is Unfairly Discriminatory within Traditional Actuarial Standards and Should Be Prohibited by Regulators Using Existing Regulatory Authority

First, it is important to state that actuarial standards are generally developed by actuaries who work for insurance companies and the effect of the standards is broaden the acceptable practices of actuaries rather than limit them.

Yet, even the actuaries, within the Actuarial Standard Of Practice (ASOP) 12 on Risk Classification, acknowledge the obvious – that a risk classification must be objectively and specifically identified:

3.2.3 Objectivity—The actuary should select risk characteristics that are capable of being objectively determined. A risk characteristic is objectively determinable if it is based on readily verifiable observable facts that cannot be easily manipulated. For example, a risk classification of “blindness” is not objective, whereas a risk classification of “vision corrected to no better than 20/100” is objective.

There is also a document called the “Risk Classification Statement of Principles,” which contains much the same guidance as the ASOP, but also includes a section on **controllability**.

Controllability refers to the ability of a risk to control its own characteristics as used in the risk classification system. While controllability is in many cases a desirable quality for a characteristic in a risk classification system to have, because of its close association with an effort to reduce hazards and the resulting general acceptability by the public, it can easily be associated with undesirable qualities, such as manipulation, impracticality and irrelevance to predictability of future costs.

Clearly, a risk classification that can be manipulated by the consumer is not objective or specifically identifiable. Further, if, for example, there are five categories of a particular risk classification, a consumer should be identified with one, and only one, category. If the categories for miles driven are 0 to 5,000; 5,001 to 7,500; 7,501 to 10,000; 10,001 to 12,500 and greater than 12,500, a consumer is eligible for one category only.

The risk classification categories must be mutually exclusive else the risk classification will be unfairly discriminatory in the actuarial sense – it will cause consumers of similar expected risk to be treated differently or cause consumers of different expected risk to be treated the same.

For example, a risk classification based on hair – length, color, thickness – would not be actuarially sound because a consumer could manipulate his or her hair – by cutting it, coloring it, treating it, having hair transplants, putting on a wig. And the hair could change over time – brown one day, grey a few weeks later.

Insurance scoring violates actuarial standards of practice because the risk classification is not objectively and specifically determinable and because it is subject to manipulation. Insurance scoring is unfairly discriminatory for the following specific reasons and should be prohibited by regulators under existing statutory authority.

Not Objective

1. Differences across credit bureaus
2. Differences within a credit bureau due to lender choices
3. Changes in definitions of credit report items – bankruptcy law change
4. Public policy initiatives changing credit scores – moratorium on foreclosures
5. Lack of information – 25% of reports contain insufficient information for scoring, clearly that 25% of population have a variety of risk characteristics
6. Timing of report – balance to limits varies by time of the month
7. Decisions of lenders – not reporting limits, changing limits

Manipulation

1. Invitations/Solicitations for Manipulation
2. Piggy-Back on another consumer
3. Shift balances from one car to multiple cards

Penalize Consumer for Rational Behavior

1. Shop around for best rates
2. Cancel a card when lender acts unfairly
3. Get a card to get 10% first visit discount

Impact of Economic Conditions / Model Versions

1. Miles driven: fewer miles driven means less exposure regardless of economic conditions
2. Delinquency: means something different in 2008 than in 2004 – FICO has updated its credit scoring model (FICO 08) to address the fact that its scoring model did not work well in predicting defaults and subprime crisis.

Multiple Models

1. Modelers produce multiple auto and homeowners models: Preferred Auto Minimum Limits; Preferred Auto Greater Than Minimum Limits, Standard Auto Minimum Limits, Standard Auto Greater Than Minimum Limits, Non-Standard Auto.
2. Consumer outcomes can vary based on which model the consumer is channeled into.

Accident Frequencies Decline as Credit Scores Worsen

There is strong evidence that insurance scoring itself is not a predictor of risk or insurance claims, but, rather, that insurance scoring is a proxy for some other factor or factors that are truly related to claim experience.

If a risk classification is truly related to claims, we expect to see that relationship hold over time and as the incidence of the risk classification in the population increases or decreases. For example, we know that fewer miles driven means, on average, less exposure to accidents and claims, while more miles driven means more exposure. If there is a significant increase or decrease in miles driven, we expect to see fewer claims.

We know that youthful drivers are more likely to be in auto accidents than drivers with greater experience. This insight has led to graduated licensing programs and a resulting reduction in youthful driver accidents. But, if the percentage of youthful drivers in the population were, for example, to double from 10% to 20% with a couple of years, there is no doubt that the overall population frequency of accidents would increase.

With insurance scoring, we do not see the relationship between credit scores and claims hold over time. Over the past two years, credit scores have suffered because of:

- an increase in loan delinquencies
- an increase in mortgage defaults
- an increase in foreclosures
- an increase in bankruptcies
- an increase in debt to limits ratios because of lenders slashing credit limits and unemployment
- an inability to tap home equity due to negative equity and tightened lending standards

All these economic results impact credit scores – payment history, public records, balance to limits ratios.

If credit scoring were truly related to the likelihood of filing a claim, then during this unprecedented period of financial stress on consumers, we would expect to see an increase in claims. Stated differently, just as we would expect an increase in claims if the percentage of youthful drivers in the population increased rapidly, we would expect an increase in claims if the percentage of consumers in the population with poor credit scores increased.

Yet, during this period of worsening credit scores, auto claim frequency has declined. The Insurance Services Office reports the following changes in claim frequency from first quarter 2006 through fourth quarter 2008:

Bodily Injury Total Limits	-10%
Property Damage Liability	-5%
Personal Injury Protection	-15%
Collision	-2%
Comprehensive	-13%

The Missouri, Texas and FTC Studies

The Missouri Department of Insurance Study

The Missouri Department of Insurance released a study that specifically examined the impact of insurance credit scoring on the availability of insurance coverage in poor and minority communities. This was the first independent study based on detailed insurance credit scoring data using rigorous statistical analysis. The Department collected credit score data aggregated at the ZIP Code level from 12 insurers for the study period of 1999 to 2001. For each Missouri ZIP Code, the Department obtained:

- Mean credit score
- The number of exposures for each of five equal credit score intervals

The Department then utilized a variety of multi-variate statistical techniques to isolate the relationship of income and race to insurance credit scoring, independent of other factors. The study found:

- ***The insurance credit-scoring system produces significantly worse scores for residents of high-minority ZIP Codes.*** The average credit score rank in “all minority” areas stood at 18.4 (of a possible 100) compared to 57.3 in “no minority” neighborhoods – a gap of 38.9 points. This study also examined the percentage of minority and white policyholders in the lower three quintiles of credit score ranges; minorities were overrepresented in this worst credit score group by 26.2 percentage points.
- ***The insurance credit-scoring systems produces [sic] significantly worse scores for residents of low-income ZIP Code.*** The gap in average credit scores between communities with \$10,953 and \$25,924 in *per capita* income (representing the poorest and wealthiest 5 percent of communities) was 12.8 percentiles. Policyholders in low-income communities were overrepresented in the worst credit score group by 7.4 percentage points compared to higher income neighborhoods.

- ***The relationship between minority concentration in a ZIP Code and credit scores remained after eliminating a broad array of socioeconomic variables, such as income, educational attainment, marital status and unemployment rates, as possible causes.*** Indeed, minority concentration proved to be the single most reliable predictor of credit scores.
- ***Minority and low-income individuals were significantly more likely to have worse credit scores than wealthier individuals and non-minorities.*** The average gap between minorities and non-minorities with poor scores was 28.9 percentage points. The gap between individuals whose family income was below the statewide median versus those with family incomes above the median was 29.2 percentage points.

Based upon the results of this study, the former Governor of Missouri has called for a ban on insurance credit scoring.

The Texas Department of Insurance Preliminary Report

The Texas Department of Insurance (TDI) reviewed over 2 million policyholder records and obtained policyholder-specific information on race. The TDI report, issued in the beginning of January 2005, states unequivocally that insurance credit scoring discriminates against minority consumers:

The individual policyholder data shows a consistent pattern of differences in credit scores among the different racial/ethnic groups. The average credit scores for Whites and Asians are better than those for Blacks and Hispanics. In addition, Blacks and Hispanics tend to be over-represented in the worse credit score categories and under-represented in the better credit score categories.²

The TDI study confirms and validates the Missouri Department of Insurance (MDI) study. Insurers complained about the Missouri study because it inferred socio-economic characteristics from ZIP Codes to average credit scores. But the MDI methodology is well accepted in the field of fair lending analysis. The TDI study not only confirms the MDI study results – it validates the MDI methodology.

² Texas Department of Insurance, “Report to the 79th Legislature: Use of Credit Information in Texas,” December 30, 2004, page 3.

The FTC Study

Mandated by Congress, the Federal Trade Commission conducted a study of insurance credit scoring for auto insurance. The study was flawed, biased and unreliable for many reasons, some of which are listed below. But even this flawed report on insurance scoring – despite relying upon data hand-picked by the insurance industry – found insurance scores were worse on average for African-Americans and Hispanics and that insurance scoring was a proxy for race. And had the FTC actually used an independent and comprehensive set of insurance data, the measured racial discrimination would have been much greater.

The FTC used only data on policies secretly selected by insurers. No data on applications that did not result in policies were obtained or analyzed. Consequently, consumers who were priced out of the market for the handful of insurers included in the study because of insurance scoring did not get counted or analyzed. It is certain that this population was disproportionately minority.

The FTC analysis of insurance scoring is deeply flawed and the report is unresponsive to its Congressional mandate. The problems include:

1. The failure to obtain a comprehensive and independent data set for analysis and the reliance upon a data set hand-picked by the insurance industry. The insurance industry effectively controlled the study by dictating the data that would be used in the study.
2. No substantive analysis of the impact of insurance scoring on the availability and affordability of insurance products as requested by Congress. Because of its reliance on industry-selected data, the FTC performed no analysis of how consumers actually fared from insurers' use of credit scoring.
3. Regurgitating insurer claims about credit scoring despite evidence that contradicts these claims. The FTC ignored evidence indicating that the correlation between insurance scores and claims was a spurious correlation – that insurance scoring was a proxy for some other factor actually related to claims.
4. The failure to analyze the "blaming-the-victim" strategy used by insurers to justify insurance scoring -- the bogus claim that people who manage their finances well are likely to manage their risks well and that's why credit scoring works. The fact is that, by the credit modelers own admission, fully 20% of the population is unscorable with tradition credit reports because of little or no information in the files. These folks are disproportionately low income and minority consumers who get charged higher rates through no fault

of their own. And even a cursory examination of actual scoring models reveals that most of the factors determining an insurance score have nothing to do with whether a consumer pays her bill on time, but with factors related to socio-economic status. Yet, the FTC report dutifully repeats this desperate rationalization for insurance scoring with no critical analysis.

5. The failure to examine any alternatives to insurance scoring that are predictive of claims but are not based on any consumer credit information. The FTC ignored research indicating that insurers could eliminate the use of credit information but obtain the same ability to predict claims with advanced modeling and data mining of traditional rating factors. Consequently, the FTC ignored an obvious alternative to insurance scoring that could reduce the impact on low income and minority consumers.



American Insurance Association



Law Department

MEMORANDUM FOR THE SUBCOMMITTEE ON NAIC MATTERS

FROM: Michael Lovendusky

SUBJECT: Credit Scoring

DATE: March 23, 1999



Attached is a new AIA Statement *On the Lack of Correlation Between Income and Credit Score*. This document updates and improves upon the AIA Statement to the NAIC delivered in the public hearing conducted in December 1998. NAIC staff has received this document and will be forwarding it to the NAIC Market Conduct and Consumer Affairs Subcommittee, chaired by Commissioner Steven Larsen (MD).

Attachment

C via email:

Berrington; Schwartz; Snyder; Young; Goldberg; Unnewehr; Giessler;
Nowakowski; Zielinski; Levy
AIA State Government Affairs Regional Offices
Eddy Lo/Fair Isaac

G:/transfer/naicsubcreditcover0399.doc

AIA CR SC Income rev 9903



American Insurance Association

Law Department

STATEMENT OF THE
AMERICAN INSURANCE ASSOCIATION

*On the
Lack of Correlation Between Income and Credit Score
Whether Tested Against the Average or Median Score*

March 1999

In December 1998, the Market Conduct and Consumer Affairs Subcommittee of the National Association of Insurance Commissioners (NAIC) conducted a public hearing on Urban Insurance Marketplaces. The Subcommittee focused on credit scoring in the business of insurance and its impact on insurance availability, affordability, accessibility and other conditions affecting consumers in urban insurance markets.

Insurers' freedom to use credit scoring as a tool to underwrite and price premium for new applicants for insurance or to evaluate insurance renewals has been hampered by unfounded fears that credit scoring operates unfairly. For example, it has been speculated that credit scoring might discriminate against populations distinguishable by income. The concern is that lower income populations fare poorly when credit scoring is used to evaluate their insurance risk characteristics.

The American Insurance Association (AIA) testified at the NAIC hearing with the benefit of member company analysis of this issue. The precise objective of the AIA company analysis was to determine the extent to which credit score is correlated with income. AIA presented important, new evidence that credit scores do *not* unfairly discriminate against or even negatively impact lower income groups. Indeed, research revealed that the lowest income groups have the highest average credit score.

Commissioner Steven Larsen (MD) questioned AIA Assistant General Counsel Michael Lovendusky whether the presentation of the data by "average score" might be enhanced by a presentation of the data by "median score by income group". AIA returned to its member company investing resources to test the utility of credit scoring for consideration of this inquiry. AIA is pleased to share with the National Association of Insurance Commissioners additional information on the data used to test the fairness of using credit scoring on a variety of individuals from all income levels; the nature of the statistical analysis; and the analytical results. The analysis concluded that *credit score is not significantly correlated with income* for the AIA company's policyholders.

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American Insurance Association
On The Lack of Correlation Between Income and Credit Score

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The Data Underlying The Study

Since 1995, the AIA company has used a credit scoring model in conjunction with other underwriting criteria. This credit scoring model was developed by Fair, Isaac and Company, Inc. It uses an individual's detailed credit history to predict his or her relative loss performance.

The credit scoring model uses characteristics from the credit history such as public notices (e.g. bankruptcies, tax liens), credit account trade line (e.g. date opened, delinquency, payment due, balance) and additional credit inquiries. It makes no use or reference to personal characteristics such as income, net worth, ethnicity and location. The model was developed with data from over a dozen insurers using over 1.4 million policies representing over \$1.5 billion in earned premium and nearly \$900 million in incurred losses. Each acceptable characteristic was evaluated as to its correlation to loss ratio and the most predictive characteristics were weighted so that the sum of the weighted characteristics is a score predicting expected loss ratio performance. The model calculates a score that ranges from 200 to 997 with 200 representing risks with the worst expected loss performance and 997 representing risks with the best expected loss performance.

The analysis was based on the Equifax PLS Credit scores for Homeowners and Personal Auto policyholders in force from 1995 through 1997. Thus it includes a broad spectrum of policyholders of varying ages, geographical areas, rating classes and incomes. Estimated income information was obtained from Axiom's Consumer Infobase™ product in terms of nine ranges: Under \$15,000, \$15-19,000, \$20-29,000, \$30-39,000, \$40-49,000, \$50-74,000, \$75-99,000, \$100-124,000 and \$125,000 or more. Both credit score and estimated income information was available for approximately 470,470 policies.

The Analysis of Income With Credit Score

A linear regression of credit score versus income computed the associated statistical parameters that measure correlation. The coefficient of correlation (R), which measures the linkage or connection between credit score and income, was calculated. A coefficient of correlation of 0% represents no correlation or linkage; a coefficient of 100% represents full correlation or linkage. The coefficient of correlation between credit score and income for the policyholders was only 2.5%, demonstrating the absence of any significant correlation.

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On The Lack of Correlation Between Income and Credit Score

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The following table displays the income distribution for the 470,470 policyholders.

INCOME DISTRIBUTION

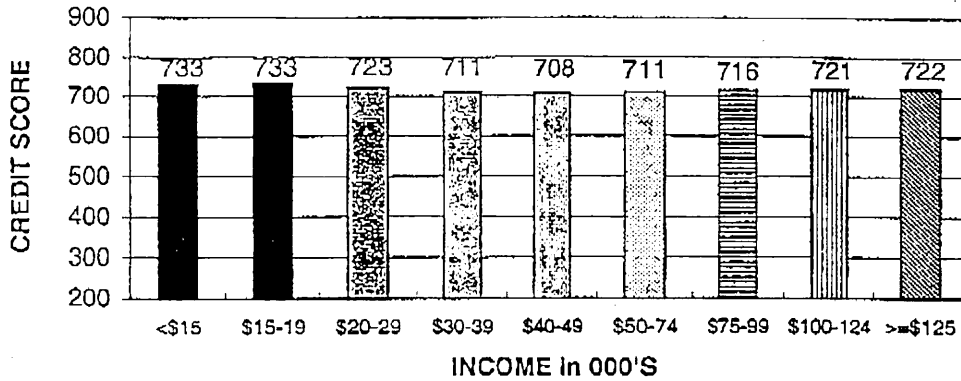
INCOME RANGE	FREQUENCY	PERCENT	CUMULATIVE PERCENT
< \$15,000	27,939	5.9%	5.9%
\$15,000- \$19,999	23,554	5.0%	10.9%
\$20,000- \$29,999	50,830	10.8%	21.7%
\$30,000- \$39,999	56,688	12.0%	33.8%
\$40,000- \$49,999	55,723	11.8%	45.6%
\$50,000- \$74,999	109,201	23.2%	68.9%
\$75,000- \$99,999	66,945	14.2%	83.1%
\$100,000- 124,999	41,300	8.8%	91.9%
\$125,000 or more	38,290	8.1%	100.0%

The Results of the Analysis of Income With Credit Score

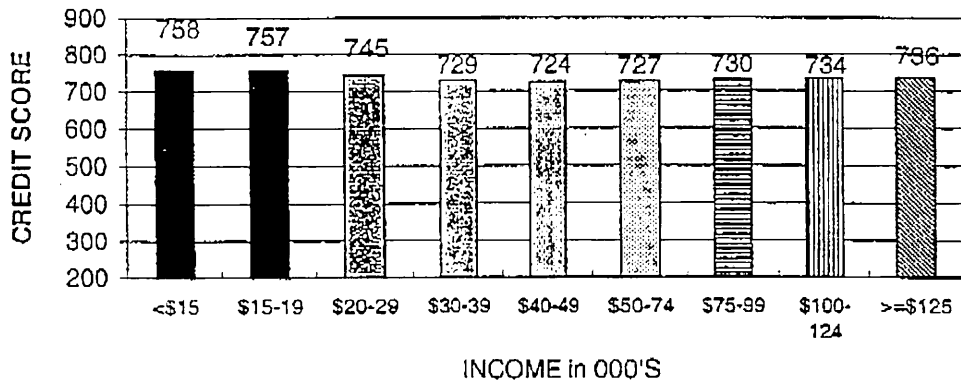
The analysis concluded that *credit score is not significantly correlated with income* for the AIA company's policyholders. This conclusion is based on the standard statistical tests of correlation. To the extent that there is a correlation, lower incomes are associated with higher credit scores. Based on the information available for company policyholders, there is no evidence that credit scores unfairly discriminate against lower income groups. The analytical results are displayed graphically below.

American Insurance Association
On The Lack of Correlation Between Income and Credit Score

AVERAGE SCORE BY INCOME GROUP



MEDIAN SCORE BY INCOME GROUP



The above two charts display the average and median credit scores for each of the nine income ranges. These charts clearly show that neither the average credit score nor the median credit score vary significantly across the income groups for the AIA company's policyholders. In addition, the variation in score is not monotonic. In other words, as income increases, score does not always increase or always decrease. Income does not have

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On The Lack of Correlation Between Income and Credit Score

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a clear impact on credit score. In fact, the lowest income groups have the highest average and median credit score.

How This Information Is Improved Over That Published in 1998

The information used for the current analysis was improved in several significant ways from that used for the 1998 AIA testimony. The updated information reflects the following:

- The score information was refreshed to obtain a better percentage of matching records. This had a minor impact on the average score versus the income chart. The chart shows the same pattern as the 1998 chart.
- The median score versus income chart is entirely new. It addresses concerns that use of average score may be misleading. Average score is not misleading; the median score chart displays the exact same pattern as the average score chart.
- The income distribution table was modified to include only those policyholders for whom the company had both credit score and income information. The 1998 information included all policyholders for which the company had income information even if it did not have credit score. The change has virtually no impact on the distribution but makes the data underlying the table completely consistent with the data underlying the charts. The company changed the number of policies cited to 470,470, which represents the policies for which it had both score and income. The 1998 information referenced 700,000 policyholders for which the company had income data.
- The coefficient cited in the statistical test section for the updated scores was updated. It changed from 4.2% to 2.5%. Both numbers indicate no significant correlation. This paper is rhetorically improved to clarify that it cites the coefficient of correlation; the 1998 testimony mistakenly referred to "the coefficient of determination."
- The AIA company policyholder information is not derived from all of its policyholders but from those underwritten from its independent agency distribution system.

Implications for Public Policy

Credit history is a source of affordable, objective information that is useful to insurers, readily available in the market, and beneficial to consumers. Insurers are expressly authorized to use credit history pursuant to the federal Fair Credit Reporting Act. This federal law also expressly bars inconsistent state regulation. The use of credit scoring for underwriting and pricing of personal lines insurance is relatively new. There is no evidence of market misconduct

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on the part of insurers using credit scoring. Such misconduct would be discoverable and punishable under existing state unfair trade practices laws. For these reasons, insurance use of credit history should not be hampered with new or special state regulation, since the mere proliferation of inconsistent state regulatory treatments will add costs and uncertainties to the use of credit history that undermine its cost-effectiveness for insurers and consumers alike.

AIA represents 387 property and casualty insurers doing business throughout the United States. AIA members wrote \$66.8 billion in direct premium -- more than 24% of the market -- in the United States in 1997, the most recent year for which data is available. In particular, AIA members wrote \$18.4 billion (30%) in homeowners' and \$11.3 billion (10%) in private passenger automobile premiums. The AIA participates extensively in NAIC discussions on the use of credit history for insurance, and cooperated with regulators notably in the formulation of the NAIC white paper on *Credit Reports and Insurance Underwriting* (1997). For more information about insurance industry interest in use of credit history, please contact

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Pages: 8 (Including Cover)

Date: 12/20/01

From: Birny Birnbaum

13. Family holdings of debt, by selected characteristics of families and type of debt, 2004–2007 surveys—*Continued*

B. 2007 Survey of Consumer Finances

Family characteristic	Secured by residential property		Installment loans	Credit card balances	Lines of credit not secured by residential property	Other	Any debt
	Primary residence	Other					
	Percentage of families holding debt						
All families	48.7	5.5	46.9	46.1	1.7	6.8	77.0
<i>Percentile of income</i>							
Less than 20	14.9	1.1	27.8	25.7	*	3.9	51.7
20–39.9	29.5	1.9	42.3	39.4	1.8	6.8	70.2
40–59.9	50.5	2.6	54.0	54.9	*	6.4	83.8
60–79.9	69.7	6.8	59.2	62.1	2.1	8.7	90.9
80–89.9	80.8	8.5	57.4	55.8	*	9.6	89.6
90–100	76.4	21.9	45.0	40.6	2.1	7.0	87.6
<i>Age of head (years)</i>							
Less than 35	37.3	3.3	65.2	48.5	2.1	5.9	83.5
35–44	59.5	6.5	56.2	51.7	2.2	7.5	86.2
45–54	65.5	8.0	51.9	53.6	1.9	9.8	86.8
55–64	55.3	7.8	44.6	49.9	1.2	8.7	81.8
65–74	42.9	5.0	26.1	37.0	1.5	4.4	65.5
75 or more	13.9	.6	7.0	18.8	*	1.3	31.4
<i>Family structure</i>							
Single with child(ren)	38.0	3.5	48.3	45.6	*	11.1	81.6
Single, no child, age less than 55	35.6	3.0	46.7	43.5	2.0	7.4	76.1
Single, no child, age 55 or more	23.2	1.8	19.4	30.5	*	4.1	49.0
Couple with child(ren)	67.0	6.9	63.9	55.7	1.9	6.5	90.4
Couple, no child	59.1	7.7	51.4	49.8	1.7	7.0	82.5
<i>Education of head</i>							
No high school diploma	26.0	1.9	33.3	26.9	*	5.3	55.5
High school diploma	45.0	3.2	46.0	46.8	1.4	6.4	75.1
Some college	46.9	6.4	54.3	51.0	2.2	9.3	80.8
College degree	61.6	8.7	49.1	50.2	1.7	6.5	85.1
<i>Race or ethnicity of respondent</i>							
White non-Hispanic	52.1	5.8	46.1	45.1	1.6	6.7	76.8
Nonwhite or Hispanic	40.4	4.8	48.9	48.4	2.0	7.0	77.7
<i>Current work status of head</i>							
Working for someone else	56.7	5.4	57.5	53.7	1.9	8.7	86.2
Self-employed	64.8	15.1	43.9	48.9	3.6	4.7	86.8
Retired	27.0	2.6	23.6	28.2	.8	3.2	52.3
Other not working	25.4	*	42.8	36.8	*	7.5	69.7
<i>Current occupation of head</i>							
Managerial or professional	67.6	10.0	56.2	52.7	1.8	7.0	90.9
Technical, sales, or services	49.7	4.5	52.2	53.2	2.7	7.9	81.8
Other occupation	53.6	5.1	57.8	53.2	2.1	9.7	84.9
Retired or other not working	26.7	2.5	26.6	29.6	.7	3.9	55.0
<i>Region</i>							
Northeast	48.4	4.9	40.7	44.3	*	5.6	73.3
Midwest	51.0	5.2	47.9	45.5	1.9	7.0	78.3
South	46.6	4.6	48.5	43.4	1.7	6.9	75.3
West	49.9	8.1	48.4	52.4	2.7	7.5	81.6
<i>Urbanicity</i>							
Metropolitan statistical area (MSA)	49.7	6.1	46.0	46.3	1.8	6.6	77.4
Non-MSA	43.5	2.9	51.2	44.8	1.6	8.0	75.0
<i>Housing status</i>							
Owner	70.9	6.9	46.1	50.1	1.3	6.8	82.4
Renter or other	*	2.6	48.6	37.3	2.8	6.9	65.4
<i>Percentile of net worth</i>							
Less than 25	11.0	*	54.2	41.0	2.6	6.7	68.9
25–49.9	56.1	3.2	52.1	52.9	1.3	8.2	82.4
50–74.9	64.3	4.8	46.1	51.7	1.6	7.4	80.3
75–89.9	63.9	8.5	39.8	44.1	1.5	3.8	76.9
90–100	62.1	21.8	28.2	30.3	1.5	6.7	75.9

18. Ratio of debt payments to family income (aggregate and median), share of debtor families with ratio greater than 40 percent, and share of debtors with any payment 60 days or more past due, 1998–2007 surveys

Percent

Family characteristic	Aggregate				Median for debtors				Debtors with ratio greater than 40 percent				Debtors with any payment past due 60 days or more			
	1998	2001	2004	2007	1998	2001	2004	2007	1998	2001	2004	2007	1998	2001	2004	2007
All families	14.9	12.9	14.4	14.5	17.9	16.7	18.0	18.6	13.6	11.8	12.2	14.7	8.1	7.0	8.9	7.1
<i>Percentile of income</i>																
Less than 20	18.8	16.1	18.2	17.6	18.6	19.2	19.7	19.0	29.8	29.3	26.8	26.9	13.0	13.4	15.9	15.1
20–39.9	16.6	15.8	16.6	17.2	17.5	16.7	17.4	17.0	18.3	16.6	18.5	19.5	12.4	11.7	13.8	11.5
40–59.9	18.7	17.1	19.4	19.8	19.4	17.6	19.5	20.3	15.9	12.3	13.7	14.5	10.0	7.9	10.4	8.3
60–79.9	19.1	16.8	18.5	21.7	19.5	18.1	20.6	21.9	9.8	6.5	7.1	12.7	5.9	4.0	7.1	4.1
80–89.9	16.8	17.0	17.3	19.7	17.8	17.2	18.1	19.3	3.5	3.5	2.4	8.1	3.9	2.6	2.3	2.1
90–100	10.3	8.1	9.3	8.4	13.7	11.2	12.7	12.5	2.8	2.0	1.8	3.8	1.6	1.3	.3	.2
<i>Age of head (years)</i>																
Less than 35	17.2	17.2	17.8	19.7	16.9	17.7	18.0	17.5	12.9	12.0	12.8	15.1	11.1	11.9	13.7	9.4
35–44	17.7	15.1	18.2	18.5	20.0	17.8	20.6	20.3	12.5	10.1	12.5	12.7	8.4	5.9	11.7	8.6
45–54	16.4	12.8	15.3	14.9	17.9	17.4	18.4	19.3	12.8	11.6	13.1	16.0	7.4	6.2	7.6	7.3
55–64	13.4	10.9	11.5	12.5	17.6	14.3	15.7	17.5	14.0	12.3	10.2	14.5	7.5	7.1	4.2	4.9
65–74	8.8	9.2	8.7	9.6	13.2	16.0	15.6	17.9	18.1	14.7	11.6	15.6	3.1	1.5	3.4	4.4
75 or more	4.1	3.9	7.1	4.4	8.1	8.0	12.8	13.0	21.4	14.6	10.7	13.9	1.1	.8	3.9	1.0
<i>Percentile of net worth</i>																
Less than 25	15.0	13.4	13.0	15.0	13.6	11.5	13.0	12.1	13.1	11.6	10.5	10.4	16.3	17.7	22.9	16.8
25–49.9	20.1	18.1	19.5	22.4	20.2	20.1	21.2	23.4	15.9	14.2	15.8	19.3	9.8	7.1	11.0	7.7
50–74.9	18.3	16.7	20.6	20.3	20.2	18.3	21.4	21.5	13.0	11.2	12.8	15.9	5.5	3.6	3.2	4.2
75–89.9	14.8	15.4	15.1	17.0	17.8	16.9	17.8	18.2	12.3	10.6	9.6	13.0	1.0	.7	1.1	1.2
90–100	10.2	7.4	8.5	8.0	14.1	11.2	12.6	12.6	12.2	8.5	7.6	11.1	2.4	.3	.1	.7
<i>Housing status</i>																
Owner	16.3	13.9	15.6	15.6	21.2	20.0	21.5	22.8	16.5	14.7	14.9	18.0	6.1	4.3	5.6	4.8
Renter or other	8.2	7.4	7.2	7.9	8.5	8.3	8.1	8.2	6.5	4.2	4.3	5.4	12.9	14.0	18.6	13.5

NOTE: The aggregate measure is the ratio of total debt payments to total income for all families. The median is the median of the distribution of ratios calculated for individual families with debt. Also see note to table 1.

The survey data for individual families may be used to construct a similar estimate of debt burden for families overall as well as for various demographic groups (table 18).⁶¹ The SCF-based estimate is the ratio of total debt payments for all families to total

family income of all families.⁶² From 2004 to 2007, the SCF-based estimate rose, albeit by less than the aggregate-level measure, increasing 0.1 percentage point, to 14.5 percent. In the previous three-year period, the SCF measure had increased at a faster pace than the aggregate-level measure; between 2001 and 2004, the aggregate estimate of the debt-burden ratio rose 1.4 percentage points, and the SCF-based measure increased 1.5 percentage points. If total payments and incomes are computed from the survey data using only families with debt payments, the results for the recent period show a slightly larger increase, from 17.7 percent in 2004 to 18.0 percent in 2007; if the ratio is computed using only families with home-secured debt, the data show a rise from 20.2 percent in 2004 to 20.5 percent in 2007 (data not shown in the tables). The SCF-based estimate of the aggregate debt-burden ratio increased for most demographic groups over the recent three-year period.

Karen Pence (2003), “Recent Changes to a Measure of U.S. Household Debt Service,” *Federal Reserve Bulletin*, vol. 89 (October), pp. 451–60.

61. The survey measure of payments relative to income may differ from the aggregate-level measure for several reasons. First, the debt payments included in each measure are different. The aggregate-level measure includes only debts originated by depositories, finance companies, and other financial institutions, whereas the survey includes, in principle, debts from all sources.

Second, the aggregate-level measure uses an estimate of disposable personal income from the national income and product accounts for the period concurrent with the estimated payments as the denominator of the ratio, whereas the survey measure uses total before-tax income reported by survey families for the preceding year; the differences in these two income measures are complex.

Third, the payments in the aggregate-level measure are estimated using a formula that entails complex assumptions about minimum payments and the distribution of loan terms at any given time; the survey measure of payments is directly asked of the survey respondents but may also include payments of taxes and insurance on real estate loans.

Fourth, because the survey measures of payments and income are based on the responses of a sample of respondents, they may be affected both by sampling error and by various types of response errors. As mentioned earlier in this article, the survey income measure tracks the most comparable measure of income in the Census Bureau’s Current Population Survey.

62. The definition of debt payments in the SCF does not include payments on leases or rental payments. The survey collects information on vehicle lease payments and rent on primary residences, and, thus, in principle a broader measure of debt payments could be constructed, one that would be similar to the “financial obligations ratio” estimated by the Federal Reserve staff.