THE IMPORTANCE OF THE NATIONAL CREDIT REPORTING SYSTEM TO CONSUMERS AND THE U.S. ECONOMY

HEARING

BEFORE THE

SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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THE IMPORTANCE OF THE NATIONAL CREDIT REPORTING SYSTEM TO CONSUMERS AND THE U.S. ECONOMY

Thursday, May 8, 2003

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

The subcommittee met, pursuant to call, at 10:10 a.m., in Room 2128, Rayburn House Office Building, Hon. Spencer Bachus [Chairman of the subcommittee] presiding.

Present: Representatives Bachus, Castle, Royce, Kelly, Gillmor, Ryun, Biggert, Capito, Tiberi, Kennedy, Hensarling, Garrett, Brown-Waite, Oxley (ex officio), Sanders, Maloney, Watt, Sherman, Meeks, Gutierrez, Moore, Gonzalez, Kanjorski, Waters, Velazquez, Hooley, Ford, Hinojosa, Lucas of Kentucky, Crowley, Israel, McCarthy and Davis

Chairman BACHUS. [Presiding.] Good morning. The subcommittee will come to order.

Last week, Chairman Oxley and Ranking Member Frank announced their intention to hold a series of hearings with respect to the Fair Credit Reporting Act, because key provisions of FCRA, which are critical to consumers, will expire at the end of this year. They have agreed to work together to develop bipartisan legislation.

This first hearing will focus on the importance of a national credit reporting system to consumers and the U.S. economy. Additional hearings will take place over the next two months and will cover a full range of issues relating to the national credit reporting system and the security of consumers personal financial information. Issues such as identity theft, which is obviously important to all of us will be addressed.

I am pleased that the Chairman and the ranking member of made FCRA and consumers personal financial information and the security thereof a top priority, and look forward to working with them on this important issue. I expect that our efforts will culminate in legislation, since key provisions of the Fair Credit Reporting Act are set to expire at the end of this year.

The U.S. economy is being supported to a great degree by consumer spending. In fact, consumer spending is vital to the strength of the economy. A critical component of consumer spending is the availability of consumer credit. For example, many major purchases, such as homes, cars, appliances, even vacation plans are financed using credit. However, we tend to take for granted the national credit reporting system that enables this credit to be extended safely and efficiently.

In fact, it is our national credit reporting system that provides a great deal of fuel to the engine of consumer spending that is currently driving our economy. Although many strong market forces have helped shape our credit reporting system over the years, the contours of the system were fundamentally defined by the basic legal framework established under the Fair Credit Reporting Act or as we refer to, FCRA.

Congress adopted FCRA in 1970. The law was passed because the banking system and consumers depend on fair and accurate credit reporting. And Congress wanted to ensure that credit bureaus exercised their important responsibilities with respect to fairness, impartiality and respect for the consumers needs and security.

Congress made some significant amendments to FCRA in 1996 to improve consumer protections and update the FCRA to better accommodate the needs of lenders, consumers, and others.

At its core FCRA is a consumer protection statute, which regulates the credit reporting process. In order to protect the customer, FCRA imposes important and strict obligations on those who provide information to credit bureaus, the credit bureaus themselves and those who receive a consumer's credit report.

The FCRA also severely limits who may see a consumer's credit report, allows consumers their access to their credit reports, and provides a mechanism under which consumers can dispute the accuracy of anything in their credit file, such as when a consumer is a victim of identity theft.

In view of FCRA's core function of regulating the credit reporting process for the benefit of the consumer, we will hear in detail today how our uniform credit system under FCRA benefits consumers and the economy as a whole.

Among the consumer benefits afforded by national credit system are efficient and convenient access to credit and insurance, strong competition in the financial market place, and lower cost of credit.

Although I have just mentioned the benefits of our national credit reporting system, or the benefits the national credit system provides customers—consumers, and the financial services sector, the stuff of our national credit system is much broader than one industry.

For example, today we will hear from two private sector witnesses as they discuss how important FRCA is to consumers with respect to other sectors of the economy, such as retail and auto sales. Although we will hear the perspective given from a retailer and an auto dealer, the subcommittee could have just as easily asked a wireless telephone provider, a utility company, a daycare center, a university, or dozens of others to describe how FCRA is important to consumers with respect to their businesses.

Several witnesses today will also describe a critical component of FCRA and our national credit system's overall success—National uniformity with respect to several areas of the law. The national uniformity provided under FCRA ensures that consumers have access to affordable credit in all 50 states, minimizes red tape, and helps prevent identity theft and fraud.

I would also like to remind the subcommittee the testimony provided by the Federal Reserve Board Chairman Alan Greenspan to the full committee just last week. When asked about the importance of FCRA's national standards for our credit system, he responded and I quote, "I have been favor of national standards here for reasons which are technically required. If you have very significant differences from state to state, it would be very hard to maintain as viable a system as we currently have." The provisions of FCRA that guarantee a single national standard with respect to many of FCRA's provisions are set to expire on January the 1st, 2004.

I share Chairman Greenspan's concern that if we have different FCRA requirements among the States, the consumer benefits and protections provided by our national systems could be destroyed.

I am extremely concerned as to how a patchwork of State laws may affect the cost and availability of credit and the security of individual consumer's financial records. I again thank Chairman Oxley and ranking member Frank for working together to move this issue forward. I encourage all members of the subcommittee, both Republican and Democrat, to follow their example as we address FCRA reform and consumers' financial security.

The Chair now recognizes the ranking member of the subcommittee, Mr. Sanders, for any opening statement he would like to make.

Mr. SANDERS. Thank you, Mr. Chairman. And thank you for holding what we all recognize is a very important hearing, and the beginning of a series of hearings on an issue which affects tens and tens of millions of Americans.

The Fair Credit Reporting Act of 1970 has made it easier for the people of our country to own their homes, automobiles, and credit cards. And that is the good news. The bad news is that errors in credit reports still exist today and have ruined the lives of millions of other Americans, by making it more expensive and difficult to purchase their own homes or their own cars.

And we all understand that this a huge problem that when people want to purchase something terribly important to them, they end up finding out that there were errors in the credit reporting system, which either jacks up the interest rates they have to pay or, in fact, in some cases, makes it impossible for them to purchase what they want.

For example, according to a report by the U.S. public interest research group, 70 percent of the credit reports they studied contained inaccuracies, 70 percent. With 29 percent containing errors serious enough to result in a denial of credit. So that is a hugely important issue that this committee must address.

In addition, the rapid increase in identity theft, as the Chairman has just indicated, caused in large part to the easy access of personal Social Security numbers and billions of unsolicited pre-approved credit applications sent through the mail each year, every year, needs to be addressed by the subcommittee. And I think we are in agreement, Mr. Chairman, about the importance of that issue.

In fact, the Federal Trade Commission reported that the number of persons filing complaints of identity theft nearly doubled from 86,000 in 2001 to 162,000 in 2002. And that the dollar losses reported by consumers skyrocketed by $160 million in 2001 to $343 million in 2002.

Bankrate.com estimates that the average identity theft victim must spend $1374 and 175 hours just to clean up their credit reports. This is a serious problem, and it is a growing problem. It is one that I hope this committee will address.

Just this morning, as it happens, on the front page of "The Washington Post," we have apparently learned just how easy it is to steal the identities of Americans. "The Post" reported that Montgomery County Police and federal investigators found a "veritable factory for counterfeit credit cards, 600 pages containing more than 40,000 allegedly stolen names and credit card numbers, more than 100 newly minted cards under 100 different names, featuring the trademark Visa logo, "Washington Post," today.

This discovery was found not at a Visa credit card company. It was discovered in just one couple's home that highlights the need for the subcommittee to find solutions to the scourge of identity theft.

But one thing I would like to make clear, despite what you may be hearing from the financial services and consumer credit industry, and this is an important point, the Federal Credit Reporting Act, FCRA, does not need to reauthorized this year, does not need to be.

The Fair Credit Reporting Act does not expire on January 1st, 2004. The only provisions that expire on January 1st, 2004 are the preemption of State laws that prohibits States from enacting stronger consumer protection statutes. That is all. That is what expires.

So if some of you have seen some of the misleading advertising from the industry, take it with a grain of salt. My own State, the State of Vermont, or the State of—my own State, my own belief is, and I believe this strongly, and I sometimes find myself in the unusual position of being the conservative on this committee, but I have heard for a long, long time——

Chairman BACHUS. Could you repeat that for the record?

Mr. SANDERS. Oh, yes.

[Laughter.]

In this discussion, there will be some people who want to play the oppressive hand of big bad federal government. Now some of us have heard that for years. We have heard that the best government is that government closest to the people. We have heard about, what is that word, devolution, giving power back to the people and back to the States.

Well, some of us champion that argument. We believe very strongly, not only on this issue, but I was yesterday meeting with women who are involved in the Breast Cancer Coalition, talking about some model programs being developed in various States in the country, that my State can learn from. And the reality is that we have 50 states.

You have extraordinary people in each of the 50 states. You have innovative ideas and legislatures in 50 of those states, Governors, Attorney Generals. And the idea, and I hate to quote Newt Gingrich, but the idea that the federal government always knows best may not be most appropriate in this issue.

And my own belief, and strong belief, is that if the State of Vermont or the State of Alabama, or any other states in this country wants to pass laws that are stronger and more pro-consumer than the federal governments, we must allow those states to do that.

That is what our government is about. We have 50 states and we have to respect those states.

According to some in the financial services and consumer credit industry, if we do not extend these states preemptions, the entire credit system will just collapse, fall apart. I think that that is patently inaccurate. And that is not true.

Let us not forget that we had a national credit system before the 1996 state preemptions, and that that system worked well. In addition, as we will hear from Professor Reidenberg this morning, the 1996 FCRA Amendment specifically, and this is important, exempted the stronger consumer protection statutes in California, in Massachusetts, and in Vermont from preemption.

What we have seen in those three states that have stronger consumer protection laws, what have we seen in those three states that are stronger consumer protection laws in regards to credit reporting?

What can we learn from that?

And what we have seen, among other things, is that in the State of Vermont, we now have the lowest rate of consumer bankruptcies in the country. Now I would be the first to admit that there are a dozen other reasons.

But it is significant to know that in the State of Vermont, which has stronger pro-consumer legislation, Vermont has the lowest rate of consumer bankruptcies in the country. The State of Massachusetts also preempted, also allowed to go forward with pro-consumer laws, has the second lowest consumer bankruptcies in the United States. And California comes in ahead of the median.

At a time when the United States as a whole is experiencing the highest rate of bankruptcy cases in our history, increasing 23 percent since 2000, I would say that these three examples give us proof that strong state consumer protection laws work.

What about mortgage rates? Well, the most recent data indicate that the State of California has the lowest effective rate for conventional—a conventional mortgage in the nation. And Vermont and Massachusetts were well below the median. And that sounds pretty good to me.

Chairman BACHUS. Mr. Sanders, if you could wrap up?

Mr. SANDERS. Well, I am almost finished, Mr. Chairman.

In addition, let us not forget why the 1996 FCRA amendments were enacted. While new members may be aware that identity theft complaints have been the number one complaint to the FDC each year since 2000, and in fact doubled from 2001 to 2002, it was credit bureau mistakes, which were the number one complaint to the FDC 10 years ago.

And it was credit bureau mistakes and complaints about them that led Congress to the 1996 FCRA amendments. From 1990 to

1992, according to a study by U.S. PERG, mistakes in credit reports were the number one complaint to the FDC.

Let me conclude simply by saying this. The issue that we are addressing today is enormously important. My hope that what we will end up with is extremely strong, pro-consumer legislation. And I think one way, one way—not only will we need a strong national floor, but we also need to allow those states who have the courage to go beyond the federal government to be able to continue to do so.

Thank you, Mr. Chairman.

Chairman BACHUS. Thank you, Mr. Sanders.

Chairman Oxley, is recognized for an opening statement.

Mr. OXLEY. Thank you, Mr. Chairman.

I am glad I came this morning to hear Bernie talk about his conservativism. And to quote Newt Gingrich——

Mr. SANDERS. Well, I think it is important to remind you of your heritage.

Mr. OXLEY. I want to welcome our old friend, Wayne Abernathy to the committee. Good to see you again, and particularly in your new position at Treasury. And our second panel also will welcome particularly Peter Swire, Professor of law at Moritz College of Law at Ohio State University. National champion. I promise that is the end of that.

Mr. Chairman, one of the hallmarks of the modern U.S. economy is quick and convenient access to consumer and mortgage credit. And although it would have seemed unimaginable just a generation ago, consumers can now qualify for a mortgage over the telephone, walk into a showroom and finance the purchase of a car in less than an hour, and get department store credit within minutes.

Over the last 30 years, consumer mortgage credit has more than doubled, and the availability of non-mortgage credit to households in the lowest quintile of income, has increased by nearly 70 percent, including a nearly three fold increase in the number of low income households owning credit cards just in the last decade.

This miracle of instant credit is only possible because of our credit reporting system. However, Federal Reserve Chairman Alan Greenspan recently testified that the credit economy, “cannot function without the credit histories of individual borrowers.”

The free flow of credit that consumers rely on depends on the free flow of information to lenders, who use that information to assess individual credit risks and extend more products accordingly.

How many times over the past two years have we heard that it is the American consumer who has almost singlehandedly kept our economy afloat? At a time in our history when consumer spending accounts for over two-thirds of gross domestic product, any disruption in the free flow of affordable credit would have serious consequences for job creation and economic growth.

Reducing the amount of information available to creditors would compromise the reliability of credit determinations, which could undermine the safety and soundness of U.S. financial institutions, and could increase the cost of credit to consumers, particularly those with less well established credit histories.

The Congressional Research Service notes that “from an economic perspective, laws that limit the reporting of credit data could impose significant financial costs on consumers and the economy as a whole."

Perhaps for this reason, our nation's top economic policymakers, including Chairman Greenspan and Secretary of Treasury John Snow have announced their strong support for extending the Fair Credit Reporting Act's uniform national standards.

In addition to maintaining the vitality of the world's most sophisticated and reliable system for the reporting of credit information, we must also ensure that when the system fails, for example, when a consumer is denied credit based upon inaccurate information, or becomes a victim of identity theft, there are procedures in place to facilitate prompt redress.

Americans are increasingly preoccupied with the security of their personal financial information, and for good reason, given the alarming rise in the reported instances of identity theft and other financial frauds.

Assistant Secretary Abernathy has previously highlighted the importance of FCRA's uniform national standards in both deterring identity theft and facilitating the repair of the victim's credit record.

One of the purposes of the series of hearings that the committee embarks upon today is to determine whether more needs to be done in this area to protect consumers. And I suspect the answer will be yes.

Ultimately, the most important protection we can provide for both consumers and for our economy is to address the renewal of FCRA's uniform consumer protections, ensuring that all consumers are treated equally under our laws and have continued access to affordable and available credit.

We are a very mobile society. We transact business across state lines virtually every minute of the day. The commerce clause was recognized by the Supreme Court as having a major effect on national economic activity. And we need to keep that in mind.

Since the uniform national standards of FCRA expire at the end of this year, over the coming months, we will be listening to a wide array of viewpoints as we gather information and opinions. The committee will take testimony and develop a comprehensive hearing record that can serve as the basis for legislative judgments on the whole range of FCRA issues.

In conclusion, I would like to thank Chairman Bachus for convening this hearing, for his continued leadership in protecting consumers and our national credit system. I would like to thank ranking minority member Mr. Frank for his support and cooperation in initiating the process in a bipartisan manner. And I hope that we can continue to work together closely as this process moves forward in the next few months.

Mr. Chairman, this legislation going forward is probably the most—certainly the most important piece of legislation that this committee will deal with the rest of this year, this congressional session. And we have tackled some important issues over the last few months in this new Congress. And we have passed them successfully and moved them onto the Senate.

But this reauthorization of FCRA is project number one for the Financial Services Committee for the foreseeable future. And certainly, the members are asked to get up to speed on these issues. And we appreciate the attendance today at this important hearing. Again, congratulations for starting this process.

This will be a deliberative process. At the end of the day, make no mistake, this committee will act. This committee will pass legislation reauthorizing the Fair Credit Reporting Act. And that is our job number one. And we will continue to pursue that effort.

Again, thank you, Mr. Chairman. I yield back.

Chairman BACHUS. I thank the Chairman. The gentle lady from New York?

Mrs. MALONEY. Thank you, Mr. Chairman. Today, this subcommittee begins consideration on the reauthorization of the Fair Credit and Reporting Act, portions of which expire at the end of the year.

This is one of the most significant topics that this subcommittee will consider possibly for many years. The FCRA has a major impact on the lives of all of our constituents. When families sit around the dinner table and make their monthly budgets, it is often the cost of credit that is the greatest variable in figuring family expenses.

All consumers should know that credit reports affect the cost of mortgages, car loans, and credit cards. What consumers may not know is that credit reports reach even deeper into their lives, impacting their employment prospects and their attractiveness as insurance risks.

The sweeping impact of the FCRA is further reinforced by a study released yesterday by the Financial Services Roundtable and reported in "The American Banker," which found that failing to reauthorize could cost the economy nearly $90 billion in GDP, $20 billion in additional incremental interest for consumers, and over 19,000 fewer single family homes.

These are incredibly large numbers, especially in a struggling economy. While the costs of failing to extend FCRA may be significant, I believe that the cost of not improving the law, while we have a chance to do so, is just as important. This subcommittee must address the tragedy that is identity theft while we have a chance.

Too often, victims of ID theft are left to fend for themselves. I have personally worked with the constituents, who must struggle to repair their credit through a process that can take several years and cost thousands of dollars.

Representative Hooley has an excellent bill on this issue, and I am proud to be a co-sponsor. I hope this bill would be considered as part of FCRA reauthorization. I also believe this debate gives us a significant opportunity to empower consumers to take more control of their credit ratings. We must take additional steps to improve credit report accuracy and increase consumer education efforts.

This is especially important for populations that have traditionally been consumers of predatory or high cost lending. Given the importance of the task before the subcommittee, I am very pleased that Assistant Secretary Abernathy is here to share the views of the Treasury Department with us. This topic is so important that the position of the Administration will have to be well defined if Congress is to act in an expeditious manner.

In this regard, I am somewhat concerned that with the exception of declaring strong opposition to identity theft, the Treasury testimony submitted to the committee this morning seems to ask more questions than it answers.

The FCRA has incredibly serious consequences for the economy and for individual consumers. I hope we can have a bipartisan agreement that strengthens this market for the benefit of consumers before the end of the year. And I yield back the balance of my time.

[The prepared statement of Hon. Carolyn B. Maloney can be found on page 78 in the appendix.]

Chairman BACHUS. Thank you. The gentleman from California?

Mr. ROYCE. Thank you, Mr. Chairman. Thanks for holding this hearing.

I think the Articles of Confederation expired in 1787, when we begin the process of drafting a national commercial system under the Constitution. I think Murray Rothbard was the last enthusiast for that patchwork quilt. I am not sure if he ever convinced Newt Gingrich, but he was a purist on the issue.

But today, consumer credit plays a major role in the U.S. economy. And today, the Federal Reserve estimates that consumers owe about $7.7 trillion in mortgage and auto and other types of loans. And I think it is fair to say that a national credit reporting system here in the United States has been crucial to the development of consumer access to credit.

And I think it is evidenced by the fact that an individual can go to any state in this country, and he can get approval or she can get approval for a car loan in a matter of minutes.

Additionally, since the national system allows providers of credit to conduct cost effective due diligence, consumers receive access to credit at one of the lowest costs in the world, a much lower cost than they would receive if we did not have this national system.

So what we want to focus on today is how do minimize errors in that system, how do we ensure that there are true disincentives that we are going to prosecute those who are involved in identity theft, what we do to make this system work more effectively.

And I think as we begin to re-engage in this debate about fair credit reporting, I look forward to hearing our witnesses' views on the issue of federal government preemption of State law in the context of the Fair Credit Reporting Act. And I think the Chairman is to be thanked for his leadership in bringing this issue now before this subcommittee.

And I would also like to take this opportunity to thank our witness Assistant Secretary Abernathy and our witnesses that are going to appear today, as we discuss with our colleagues the best solution for the consumers in this country and for our U.S. economy. And I yield back the balance of my time.

Chairman BACHUS. Thank you.

Is there another member in the minority? Mrs.—Mr. Moore, Ms. Hooley, I am not sure. Ms. Hooley?

Ms. HOOLEY. Mr. Chairman? Are you ready? Okay.

Thank you, Mr. Chairman and ranking member Sanders. I look forward to the first of these hearings on whether or not to reauthorize the seven expiring provisions of FCRA. As I have said to everyone I have met on this subject, I am convinced the credit system in place in the United States is the best credit system in the world.

The supremacy of the credit system is no doubt a result of the strength of our financial industry, the watchfulness of our consumer groups, and the thoughtfulness of past congresses.

I am very hopeful that we in the 108th Congress follow the example of past congresses and debate and consider reauthorization of FCRA with the same amount of diligence. While I mentioned that I believe we have the best credit system in the world, I also see room for improvement, both in industry practices, and in government regulation.

But foremost on my mind is the rising problem of identity theft. The problem is receiving more and more public and media attention. Representative Sanders mentioned the article in "The Post," the front page. Well, this article and these kinds of articles appear every single day in every newspaper across the United States.

We need to do whatever we can to stop this criminal activity. A 2003 survey I recently saw found that 92 percent of Americans think it is important that government take action on the issue of identity theft. I know many of us think it is inappropriate to govern by polls, but we cannot and must not ignore the fact that Americans throughout the country are begging for us to act and help them.

Today, with Mr. LaTourette, I am introducing the Identity Theft Bill. We have about 40 co-sponsors, many of them sitting in this room. But this bill is just one of many being considered by this committee, dealing with identity theft. Many of my colleagues also have great ideas and have built up.

But identity theft is going to take all of us working together to solve this problem. Assistant Secretary Abernathy, you have made comments publicly stating your support for legislation to help fight identity theft. And each time I read those comments, I welcome them for I think this must be a central part of the debate.

We have sent a copy of our legislation over to you. I hope you will look at and again comment on it, criticize it, and give us your ideas. I thank each of the witnesses that are with us today for taking your time to help this committee. I look forward to the continued debate. And, again, trying to keep an eye on helping our fellow Americans with identity theft and with our credit reporting system, and with our financial systems.

Thank you. I yield back the rest—the remainder of my time.

[The prepared statement of Hon. Darlene Hooley can be found on page 76 in the appendix.]

Chairman BACHUS. Thank you. The gentleman from Texas?

Mr. HINOJOSA. Thank you, Chairman Bachus. I have a statement, but rather than read it, I think I would like to just ask for your permission to enter it in its entirety into the record, together with a memorandum that I have as an attachment to this—to these remarks.

Chairman BACHUS. Without objection. And Mr. Hensarling?

Mr. HENSARLING. Thank you, Mr. Chairman. I would just like to state for the record that it has been my honor and privilege to know this witness I believe for over 15 years now. I know him to be a man of keen intellect, a man of great integrity. Obviously, he is one of the undisputed experts in the area in which we are hearing testimony today, but if my memory serves me right, I must admit that his softball playing expertise must be called into question.

The nation's benefited from his public service. And I look forward to hearing his testimony today, Mr. Chairman.

Chairman BACHUS. I thank the gentleman. I think that is an appropriate introduction for our first witness. And so we will go from there.

I do want to say this, I think the Statements on both sides have illustrated quite accurately that we are talking about one subject, but it has many facets. We are talking about the National Credit Reporting System. We are also talking about the need for consumers to have their consumer—their financial information, security for that information, and also that their information be accurate, and that they be able to correct mistakes in their credit report.

It is important, I think, for our economy, for availability of consumer credit across state lines, for us to address all these issues. But they are not mutually exclusive. It is not an either/or situation. In fact, the issues are synonymous when we talk about the need for a viable National Credit Reporting System or sustaining one. We also—the need is there for an accurate system. The need is there for a secure system. So they are one in the same when we discuss these problems.

And I think that when we address national credit reporting system, it is only natural for us to talk about identity theft, because it is all a part of the same issue.

And we certainly do not want a system where we have widespread identity theft. Nor do we want a system where consumers cannot respond and correct it. I recognize Ms. Waters and then we will go to the first panel.

Ms. WATERS. Thank you very much, Mr. Chairman. I really had not intended to do an opening statement. But as I listen to you, I am reminded why many of us decided to be elected officials. There is no greater service that we can perform, than protecting consumers. Our consumers are at the mercy of very complicated systems, applying for credit, you know, paying bills, trying to protect their privacy, and trying to understand the systems that determine the quality of life they are going to have.

In this committee, we get the opportunity to serve, perhaps, in the best way possible, by putting aside any alliances we may have with special interest groups, and focusing on what we can do, number one, to protect the consumers in everything from credit reporting to the operation of the Fair Credit Reporting Act, in any and all ways that we can.

And we must remember that we want the best possible opportunities for protection for protection for our consumers. And if states can do this, we must not get in the way of States who will have stronger laws for protecting consumers by somehow preempting them. That is a very serious issue that we have to look at.

This business of the credit scoring, I hear so many complaints about mistakes that are made. And people are denied the opportunity to realize the American dream of a home because the credit reporting is inaccurate. And we must correct that. And we must now have consumers at the mercy of agencies that are either careless in their work, or for some reason, they are not interested in doing the absolute best job that they can do.

And, finally, this business of identity theft must be dealt with. And when it happens, we cannot have consumers taking a year or so out of their lives to correct it. I know people who are working almost into two years to correct the identity theft. We can do better than that. And Mr. Chairman, let me just say if we cannot get it right here in this committee, with subject matter, than none of us need to be here.

Thank you very much. And I yield back the balance of my time.

Chairman BACHUS. I thank the lady for her remarks.

At this time, our first witness, and you heard from Mr. Hensarling about our first witness, but Assistant Secretary Abernathy was sworn in as Treasury Assistant Secretary for Financial Institutions in December of 2002, after being nominated by the President on August 1st of last year.

But I think more importantly to this committee, he brings 20 years of financial policy expertise to that position, having most recently served as Staff Director of the U.S. Senate Committee on Banking, Housing and Urban Affairs.

So Mr. Abernathy or Secretary Abernathy, most of us are well aware of your expertise and your knowledge in this area. And we very much welcome your comments this morning.

STATEMENT OF HON. WAYNE ABERNATHY, ASSISTANT SECRETARY FOR FINANCIAL INSTITUTIONS, DEPARTMENT OF TREASURY

Mr. ABERNATHY. Thank you, Mr. Chairman, Representative Sanders, members of the subcommittee. It is an honor to be here before you today in this capacity. I agree with the comments that I have heard here. I think there could hardly be——

Chairman BACHUS. Sort of come to order. And thank you, Mr. Abernathy.

Mr. ABERNATHY. Thank you, Mr. Chairman. And I would also ask if my full statement would be placed in the record. And I will summarize for the benefit of the committee.

There could hardly be a more important subject to consider than the information infrastructure of our financial system. So much of the economy and the welfare of every participant in that economy is dependent on getting right the legal structure of our financial system, particularly of the financial information infrastructure.

In 1996, the Congress undertook an experiment with uniform national standards for financial information sharing. It is appropriate now that Congress evaluate what the results of those—that experiment are. And we are eager to participate in that evaluation, as we develop Administration policy.

We should keep in mind that all Americans have two very important interests with respect to this matter. First of all, they have an interest in the widest availability of financial services at the lowest cost to as many people as possible.

Second, they have a strong interest in the security of the personal financial information that is related to the availability of those financial services. These two interests together need to be weighed, and taken together, and accommodated together. And I believe that they can be. We would suggest considering the following questions, as we begin this process.

Do uniform national standards facilitate or harm the fight against identity theft?

Do uniform national standards reduce or increase the cost to the consumer of financial services?

Do uniform national standards bring more or fewer people into the mainstream of financial services?

To what extent do uniform national standards help or hinder job creation?

Is small business development helped or harmed by uniform national standards?

In short, what costs and benefits to the economy as a whole can be attributed to uniform national standards?

And what would be the economic impact, if they were allowed to expire?

One area that we have been particularly concerned with is the role that the FCRA uniform national standards play in the fight against identity theft. The importance of this concern can be understood by a brief review of the nature of the crime.

Identity theft is one of the fastest growing crimes in America today. By some estimates, there will be as many as one million new casualties, new victims to identity theft this year, with many times that number already in the ranks of sufferers.

In a recent national survey of homeowners, 12 percent reported having been victims of identity theft. Few other crimes have touched such a large portion of Americans. In that same survey, 90 percent said they were concerned that they might be a target of identity theft. A separate survey recently found that Americans are more concerned about being a victim of identity theft than they are about losing their jobs.

The crime of identity theft occurs in great variety. As I speak, somewhere someone is using someone else's good name to engage in fraud, to steal from a furniture store, to rob a bank account, engage in stock swindles, write bad checks, run up huge phone bills, escape gambling debts, shield illegal drug deals, create false resumes, impersonate doctors, or other professionals, destroy reputations.

And do not look for patriotism among identity thieves. When our soldiers, sailors and airmen moved to the front to engage the enemy, the identity thieves are ready to take advantage of their absence, to steal their identities, to engage in fraud.

I would guess that the soldier in the 3rd Infantry Division in Baghdad was not giving much thought today to his bank account, or worrying about his credit cards. He is certainly not looking at his financial statements, but the fraudster's paying attention. For he knows that the fraud could go undetected for a long period of time unless friends and family are vigilant, on the watch here at home over the financial affairs of this serviceman or woman overseas.

Arguably, the most virulent form of identity theft occurs when the crook takes your good name and uses it to open new accounts, that you know nothing of, with statements going to places that you have never been, so that weeks and months pass without your knowledge of the fraud.

The crook may even keep up minimum payments for a period of time, until they max out on the credit limits. Then he disappears. The payments stop and the creditors come looking. But they do not come looking for the crook. They do not find the crook. They look for you. And then you will see perhaps the most painful of all the many faces associated with the crime of identity theft, the face of the victim.

Where do you go? How do you begin to clear your name? How do you convince creditors all around the country that you never made those transactions, that there must be some mistake? Remember, crooks have long sought to exploit state lines to avoid punishment.

The General Accounting Office reports that it can take victims as many as 175 hours, man hours, to clear their name and their records. Now what role have the uniform national standards under the FCRA to play? And what role have they played in the fight against identity theft?

What role might they play in the future? Are they more likely to cause the crime? Or can they be enlisted in the fight against it? Certainly, the crook uses information to craft a mask, as much in the likeness of the victim as he can make it. What steps can we take to deny the thief the information tools he needs to make—to take away the mask?

In what way might we be able to put information to work, to fight the crime? If the merchant or banker knows more about his customer than the identity thief does, can we unmask the crook and prevent a loss from occurring? If information about the thief can cross state lines faster than he can, might we enable the sheriff to meet the thief at his next stop?

And what role does information play in restoring the records of victims? Can it be harnessed in the effort to eradicate the false information? As we consider the uniform standards for information sharing under the FCRA, we anticipate working together with you, to consider how this review can help in this crucial fight against identity theft.

And so as I said in the beginning, whether considered from the impact on each family in America or on the economy as a whole, there could hardly be a more important inquiry than the one you begin today. Thank you and I will now be pleased to answer questions.

[The prepared statement of Hon. Wayne Abernathy can be found on page 80 in the appendix.]

Chairman BACHUS. I thank the Assistant Secretary. Mr. Abernathy, you state in your testimony that since the experiment with uniform national standards under FCRA began, we have witnessed a significant increase in the availability of credit to Americans.

Given that consumer spending now accounts for over two-thirds of our country's gross domestic product, and I think you heard the Chairman mention that in his opening statement, is it safe to assume that any significant reduction in the availability of consumer credit would have serious negative consequences for the U.S. economy?

Mr. ABERNATHY. I think that has been very clear. As many have pointed out, one of the positive factors that we have had in the economy recently has been the fact that we have been able to sustain consumer spending.

And where would the economy be if that had not happened?

I think it is easy to say and undeniable that we would have been in very serious circumstances. The economic downturn would not have been as brief, would have probably been steeper, would have taken us a lot more time to get out of it.

Chairman BACHUS. Anything that we do we limit consumer spending, obviously has a detrimental effect on the economy and the national—the uniform national standards have resulted in an increase in consumer spending, is that safe to say?

Mr. ABERNATHY. The various studies that I have seen so far, and there are more that are coming forward, all point in that direction.

Chairman BACHUS. Thank you.

Can information sharing and pre-screening help target economic resources more efficiently and get consumer products they want, instead of junk they do not?

Mr. ABERNATHY. That is one of the things that we need to evaluate, one of the interesting questions that would be interesting to pose to a group of people. And try this sometime in an audience. Ask them how many of you here wish that you never got ever again a pre-screened credit solicitation in the mail?

And you can see a lot of hands go up. Then ask how many of you people, the same ones, currently hold a credit card that you obtained through a pre-screen solicitation. And very likely, you will see almost the same hands go up.

People, I think, a little bit of two minds of this process. And that is why we think we need to look at this in its entirety, again keeping in mind that there are two goals here that we need to achieve, and that I think are both achievable—facilitating the provision of credit and financial services to consumers, at the same time protecting the security of their financial information.

Chairman BACHUS. I tell you, I can speak for one consumer, myself. I think these activities of receiving a pre-screening often in the mail is certainly less intrusive than mass telemarketing appeals that come at 8:00 at night or during the middle of a football game.

Isn't a certain level of information sharing under FCRA helpful in combating identity theft and fraud? And doesn't having national uniform standards facilitate a company's ability to utilize additional authentications and identity verifications to protect consumer security?

Mr. ABERNATHY. Yes, as we have been trying to come to grips with this problem of identity theft, we have talked to a lot of people. We have talked to victims from all around the country. We have talked to law enforcement people. We have talked to regulators.

We have talked to industry. And we have asked them, just what can be done to improve the effort to fight identity theft? And every one of them constantly emphasizes the importance of information as the tool, the single most important tool for fighting identity theft.

So, again, remember, identity theft takes place when the crook puts on a mask. He is pretending to be somebody he is not. If we can find the way to see behind that mask, perhaps at the point of sale, at the point of transaction, we can stop a lot of identity theft from occurring. But that means information has to move quickly and it has to be accurate.

Chairman BACHUS. And authentications and verifications are a part of the national credit reporting system, aren't they?

Mr. ABERNATHY. They are. And it is an interesting pattern, as we talked to people. It used to be not terribly long ago that financial services providers, retailers, rely upon a single source of identity verification. They have discovered now that what they need to do is rely upon a package. And they need to be able to change that package, because the identity thieves are figuring these things out. And it used to be, well maybe your mother's maiden name is a unique identifier.

We had a high official at the Treasury Department give my staff a Rumpelstiltskin kind of test a little while ago. He said by tomorrow, tell me my mother's maiden name. My staff did it. They were able to keep their first-born, but it demonstrates that whatever these unique identifiers are, they change.

And what is needed is to allow the ability of the financial service provider, the retailer, to be able to change those unique identifiers faster than the crooks can.

Again, it is important that they know more about their customer than the thief does.

Chairman BACHUS. Thank you. Mr. Sanders?

Mr. SANDERS. Thank you, Mr. Chairman and thank you, Mr. Abernathy for your testimony.

Mr. ABERNATHY. Thank you.

Mr. SANDERS. From what we have heard this morning, I think from everyone, we all recognize the importance of this issue. And among other things, we all recognize the tragedy of identity theft.

And, obviously, the devil will be in the details, but I hope that we can all work together to deal with this scourge that is affecting so many American people. And we appreciate your help and comments on that issue.

It seems to me that the best thing that we can do as a committee, as a Congress, is to pass the strongest possible national legislation as a floor, but to allow those states that want to go beyond that to be able to do so.

I will give you an example. In the State of Vermont right now, to the best of my knowledge, and in some other states, if you as a consumer want, you can get a free credit report from one of the bureaus. That exist in some states, but not in all states. It is just a minority of States. I think that is a good idea.

I will fight to see that that exists in 50 states, but my question to you is if I am not successful, do you think that legislation should be passed which would preempt the State of Arizona or New Mexico from doing what seven states or so do right now, if they choose to do that?

Mr. ABERNATHY. Thank you, Mr. Sanders. I think as we evaluate how well the current system is working, and that is in essence what we are talking about. How has the current system worked, the uniform national standards, the seven that occur in the FCRA?

I think we need to look at that experiment in a couple of ways. And I think you point out that the Vermont example is part of that experiment. While we have been conducting an experiment nationwide of uniform national standards, we have had a couple of experiments going on simultaneously where that is different. And I think we need to evaluate what the data and the information tells us in all of those cases.

With regard to the free credit report, as we have been putting together a number of different suggestions on how to tackle the issue of identity theft, that has been one of the suggestions that has been made to us from a number of different parties. And I think there is a lot of merit to it.

As I have been saying to the credit reporting agencies, and particularly to their customers, there is a strong interest on the part of the user of their product that their information be accurate. A bank wants to be able to provide financial services. They want to be able to target the financial service as carefully as possible for their customer as they can.

One of the great phenomenon that has occurred in the last several years in financial services is the ability to tailor make products. But the only way you can tailor make a financial service for somebody is making sure the information you have is right.

And I wonder what impact it would have on the accuracy of information if we had 150 million people verifying the information that is there. I have to think that you would be enlisting the people who would be most interested and most sensitive to making sure that information is correct.

Mr. SANDERS. I do not mean to put you on the spot, and I very much appreciate your comments, but what I am hearing you say is that you are not unfavorably disposed to us having national legislation which would allow every American to gain full free access to their credit history? Is that roughly what I am hearing you say?

Mr. ABERNATHY. That is very much on the table if things were considered.

Mr. SANDERS. Okay, well, I appreciate that very much. Thank you very much, Mr. Abernathy.

Mr. ABERNATHY. Thank you.

Chairman BACHUS. Let me read out the list of Members in the order that the committee staff has given me, and let us make sure that we are all on the same page here. I have the next person that is here on our side as Mr. Kennedy, that he would be our first Member to ask questions. And then we would go to Ms. Maloney.

Then we go to Mr. Hensarling. Then Mr. Meeks, then Mr. Garrett, Mr. Moore, Ms. Biggert, Ms. Velazquez, Ms. Capito, then Ms. Hooley, Mr. Tiberi, then Mr. Gutierrez is not here any longer so

Mr. Hinojosa, Mr. Castle, Mr. Davis. And then on this side, I have Lucas, Davis, McCarthy, Ford, and Gonzalez. Is that—was that the—Mr. Gonzalez, have you been here since the start?

Mr. GONZALEZ. More or less, sir. I got here at——

Chairman BACHUS. That is what I was thinking.

Mr. GONZALEZ. 15 minutes late.

Chairman BACHUS. This part is a little inaccurate. So I am going to try to work with that, but——

Mr. GONZALEZ. Thank you.

Chairman BACHUS. But that will give somewhat of a——

Mr. SANDERS. We stand in reporting, Mr. Chairman.

Chairman BACHUS. Say what? That is right, that it is—this system that we have of who comes in is a little hard sometimes to order, but Mr. Kennedy?

Mr. KENNEDY. I thank you. And thank you for your testimony.

I would like to just have you clarify again what benefit or harm it would cause to the economy to commercial business if there were rights for the States to over and above what was enacted through Fair Credit Reporting Act, be able to put on more stricter provisions in the States?

Mr. ABERNATHY. Mr. Kennedy, that is something that we are examining right now at the Administration, just what would be the impact if the uniform national standards that are currently in place were allowed to expire at the end of the year. From the point of view, sort of a micro level, what impact would it have on individual families? But also, what impact would it have on the economy as a whole?

All of the studies that I have seen so far indicate that the impact would not be immediate, but that the impact would progressively grow and could become very large. But we are right now evaluating that.

Mr. KENNEDY. And do you have any studies as to the cost that would be incurred by financial businesses if there was a patchwork quilt of regulations that needed to be dealt with around the country, and how much that would affect the cost of financial services to consumers?

Mr. ABERNATHY. We have seen a number of studies. I think there are some other work that it is going to provided probably in the next week or two from some private parties. I think your witnesses are going to be presenting some findings of their research. The Council of Economic Advisers is not only evaluating that, but we are doing some of our research on our own.

I would say there are preliminary information that some of these studies point at, but we want to make sure that we have the whole picture together before we say exactly what that impact would be. But I think it is undeniable that we are talking about something that is significant.

Mr. KENNEDY. Thank you.

And as we look at identity theft, you know, we in this new post 9/11 world have looked at a lot of homeland security proposals for how we can certify someone's true identity, including biometrics and other measures, to confirm that the person we are talking about truly is that person.

Has there been any creativity seen in other countries, in other applications, that could help us assure that the person using the credit is in fact that person?

Mr. ABERNATHY. There are a lot of very interesting things being done in the world of technology with regard to verifying identities. And certainly, we want to make sure that we do not do anything that discourages use and putting in place of the technologies that will help in that regard.

I think also, though, that there are things that we can do legislatively and perhaps regulatorily, that will facilitate the ability to verify who people are.

Mr. KENNEDY. Good, thank you for your testimony.

Mr. ABERNATHY. Thank you.

Chairman BACHUS. Ms. Maloney?

Mrs. MALONEY. Okay, thank you, Mr. Chairman. And welcome Assistant Secretary. I appreciate very much your appearance today, since we have something now very much in common. Your former boss, Senator Gramm, is now one of my constituents. So I can say we are both working or have worked for the same person.

Mr. ABERNATHY. He is working on the accent.

Mrs. MALONEY. Anyway, I truly appreciate your testimony. And I appreciate the lengthy discussion on identity theft in your testimony. It is truly a huge problem. And many of my constituents have been affected by it.

But beyond identity theft, does the Administration have a position on reauthorization of FCRA? Do they have a position?

Mr. ABERNATHY. We have a position. We do not have the final position yet. We are in a process. I think much the same process that is taken place here in the Congress.

Our position is, as we begin this process, that there are two very important interests that must be part of whatever the final legislation or solution or action is. And that is, that whatever we do, we have to make sure that we are facilitating access to credit for as many people as possible, in as wide a variety as possible, while also improving and increasing the security of the information.

If we can bring those two goals together, which I think we can, then I think we will have legislation that at the end of the year would better the circumstance of the consumers, which as I think as many pointed out, really need to be the focus of what we are doing.

Mrs. MALONEY. So this proposal will not be ready until when, January you say or?

Mr. ABERNATHY. No, I am saying where we are now is we have focused on what these two things are that need to be accomplished.

Mrs. MALONEY. Yes, I think we all agree with that, but when can we hear from the Administration what their position is?

Mr. ABERNATHY. It is a top priority, not only for the Treasury Department, but for the Administration as well. I think the answer of when we have the package of things that we think ought——

Mrs. MALONEY. And when do you estimate that will be? In a month or two or three or six or 10 or?

Mr. ABERNATHY. I would say the sooner the better.

Mrs. MALONEY. The sooner the better.

Mr. ABERNATHY. It is just a matter of when we have the—when we have all the pieces together for it to be a comprehensive set of actions.

Mrs. MALONEY. Okay. We cannot pin you down. You are like Greenspan. You are not going to tell us when you are going to have that. But does the Administration have any position on the privacy related ballot initiative in California that deals with Gramm-Leach-Bliley privacy provisions?

Mr. ABERNATHY. Now I do not believe the Administration has any position on that. Frankly, we do not make a habit of looking very closely at legislation that is before particularly states. I will say in as much as that impacts what is being done at the federal level in this area, we want to make sure that we can achieve those two goals that I have outlined.

Mrs. MALONEY. Also, among the functions of the seven provisions in FCRA that are expiring are exemptions dealing with loan underwriting, and preemptions that make it easier for companies to market products. So those are two of the preemptions, the loan underwriting and the marketing of products.

Some observers contend that it is impossible to separate the two. Does Treasury have any position on the relative importance of reauthorizing preemptions for underwriting versus marketing? And do you agree that the two are interrelated and inseparable? Or do you feel that the two can be separated?

Mr. ABERNATHY. No, I think you correctly point out that we need to consider that in the FCRA, there are seven particular uniform national standards. I think they are closely related, but I do not think that they are inseparable.

I think each one has its own particular purpose. They each relate to one another. And part of, I think the process in coming up with a uniform policy that makes sense for customers is being aware of how they relate to one another.

Mrs. MALONEY. In your testimony, and you spoke quite lengthily on identity theft, and you did note that you are concerned about the role that FCRA uniform national standards play in the fight against identity theft. And do you have any concrete recommendations for strengthening the provisions to fight identity theft?

Mr. ABERNATHY. We have a number of things that we are looking at. And that, frankly, is part of the package that we hope to bring to you is——

Mrs. MALONEY. Can you share some of those ideas now or?

Mr. ABERNATHY. I would love to that, but what I have learned, one of the best processes that you have in work in the Administration is, when you have a good idea, you have to make sure the corners get rubbed off, if there are problems or any burrs on. And we are going through that interagency process right now.

So rather than share them, and then say, well, I have discovered there is a piece where it can be done better, we would like to make sure we have a good product before we bring it forward.

Mrs. MALONEY. In Peter Swire's testimony on the second panel, he addresses reports that the Administration is circulating a draft of PATRIOT 2 that would give unprecedented access to credit reports to government agencies.

The proposal in section 126 of the draft PATRIOT 2 Act is titled "Equal Access to Consumer Credit Reports," but Mr. Swire contends it would allow law enforcement officials to get any credit report with a simple certification that they will use the information, and I quote "only in connection with their duties to enforce federal law."

There are no limits on redisclosure to other agencies and no mechanisms at all to ensure that the credit reports will be used for the Stated purpose, once they are given to the government. And does Treasury support this proposal? And could you please respond to Mr. Swire's criticisms?

Mr. ABERNATHY. If I could get back to you on that, Mrs. Maloney. I have not been part of any of those discussions, but I can certainly make sure that that question is taken back to those at Treasury that do work with that legislation.

Mrs. MALONEY. Well, I thank you. And you will get back to us in writing or how——

Mr. ABERNATHY. If you would like, yes, we can——

Mrs. MALONEY. Whatever way. Thank you.

Mr. ABERNATHY. Sure. Happy to do that.

Mrs. MALONEY. Thank you.

Chairman BACHUS. Ms. Kelly?

Mrs. KELLY. Thank you very much, Mr. Chairman.

Mr. Abernathy, it is nice to have you here again.

Mr. ABERNATHY. Thank you.

Mrs. KELLY. I am pleased that Chairman Greenspan and Secretary Snow have both endorsed the extension of the FCRA's uniform standards. And I share their views that a failure to reauthorize the FCRA would have a negative impact on the flow of credit and on our economy.

As you know, this committee's worked really hard to combat money laundering through the PATRIOT Act. We found that both criminals and terrorists use complex and very sophisticated schemes to manipulate the laws and our financial systems.

Their deception is spread across many entities. And it has continued to expand. I personally am concerned that not extending the FCRA may affect our ability to detect suspicious activity. I wonder if you could comment on the impact that failure to reauthorize the FCRA may have on our ability to carry out the PATRIOT Act?

Mr. ABERNATHY. I think that is certainly one of the things that needs to be weighed, as we examine this—these uniform standards and how they operate, not only from the point of view of what we would consider traditional relationships between a customer and their financial services provider, but also the—how they might help us in a law enforcement way to combat things like money laundering.

One of the things that I continue to emphasize to the people in Treasury that do the day to day work on money laundering is that we need to maintain a cooperative relationship with the financial institutions in order to get the best kind of information on who the crooks are.

And it may be that the ability to have uniform ways of reporting information are central to that responsibility, central to that effort.

Mrs. KELLY. There is another troubling issue on which I have held hearings with Mr. Bachus. And that is identity theft.

Could you tell me your thoughts on how the FCRA and the information sharing that it provides has helped combat identity theft?

Mr. ABERNATHY. I can give you one example in particular that recently brought home to us. My wife thought it would be a great idea from my father-in-law for a gift to buy him a riding lawnmower so he would not have to mow his acre and a half in the countryside of western New York by hand. Or actually, she was concerned that her mother was doing that and that maybe if they got a riding lawnmower, dad would get out there and drive thing and do the mowing.

Well, after we bought that riding lawnmower, the very next day, we got a phone call. And the phone call was not from my in-laws. They would have called a little earlier than that. We got a phone call from our credit card company.

They said, "Did you make a purchase in upstate New York at a garden supply store?" And we said, "Yes." They said, "Okay, just wanted to know."

They were using information that they were able to obtain, facilitated by the Fair Credit Reporting Act to verify whether that was a legitimate transaction or not. And my wife's reaction was gee, I am awfully glad they are doing that and that they can do that.

In many cases, I have heard of other cases where identity thefts have been discovered through that same set of process.

Mrs. KELLY. At one of our earlier committee hearings on identity theft, we had an expert security consultant that came in and testified that we need better practice standards to be implemented for information, security and auditing procedures. This is an issue that you think we ought to be taking a look at with more closely with regard to the FCRA?

Mr. ABERNATHY. Yeah, I think that all of these issues have to be on the table. And we have a great opportunity be doing that. And that certainly would be an important one as well.

Not all that we need to do needs to be done legislatively or regulatorily. There are also important best practices that can be developed.

Mrs. KELLY. Do you think there are potential ways that we can help consumers get more information to help them combat identity theft and fraud or to help coordinate with local—with law enforcement people and to—I do not know if that is increased penalties or some kind of information sharing that could happen. It seems to me that perhaps we can energize consumers themselves to do a bit more to help protect against identity theft?

Mr. ABERNATHY. Yeah, they really are the first line. And I think a lot of identity theft can be stopped if people knew a little bit more about their credit reports, how the financial system operates. One of the other things that I spent a lot of my time, one of the responsibilities I have is financial education.

There is a crying need in this nation to improve the level of financial literacy. It is amazing to me the kinds of mistakes and trouble that people get into and might have been able to avoid had they known some of the basic rules of what we might call financial literacy of how financial affairs operate.

I think that certain types of information can be very helpful. I am eager to see the day when the average customer is able to put a stop to a lot of these problems just on their initiative. I do not think that is enough. I think there are a lot of other things that need to be done, but that is got to be an important part of it.

Mrs. KELLY. I am glad to hear you say that. I believe that financial literacy is something that is at a very low level, in general, in this nation. And we do need to do something about it.

And with the addition of the Smart technology that it seems to be coming more and more available, that is a potential thing. So anything you can help us with on that score I certainly think this committee would be grateful for. And I thank you and turn back the balance of my time.

Chairman BACHUS. Thank you, Ms. Kelly. Mr. Meeks?

Mr. MEEKS. Thank you, Mr. Chairman.

Mr. Abernathy, let me first—I do not know, I want to ask a question. It is something that has been happening with some constituents of mine and that they have been complaining about recently. Find out if you are aware about it, and what if anything you would recommend to be done?

Recently, I have had a number of complaints from individuals talking about insurance companies who are actually using credit information as a factor to increase or decrease their auto insurance, even though they may have a great drivers record, never had an accident, never had any problem, but if they had a problem with their credit, they have a credit report, that is causing the insurance companies to charge higher rates.

Have you heard of anything of this nature? And if so, what would you recommend be done about it?

Mr. ABERNATHY. I have heard anecdotes. Nothing in any kind of systematic way. Maybe I have heard some of the same kinds of complaints that you have. As you know, insurance is regulated at the State level. We do not have any federal insurance rules with regard to that.

There is obviously a strong interest on the part of insurance companies in particular to get the risk right. The way an insurance company makes money is by accurately, as accurately as they possibly can, identifying what the risk is of each particular customer.

And the way they compete with one another in many ways is how they can identify that risk better than their competitor can. There are other elements that they use to compete with, but that is an important part.

To the extent an insurance company gets that risk wrong, either by charging too much of a premium for a customer or too low of a premium, in the end, they will lose money. So I would think that over time, companies could not get away with that sort of practice.

Inasmuch as there is a practice that they are engaging in that is unfair, I would hope and would expect that the State regulators would be involved with that and that those kinds of complaints would be brought to their state regulator.

Mr. MEEKS. Let me also ask this question. The sharing of information, you know, since we have enacted Gramm-Leach-Bliley, I understand about people not wanting to opt in. They opt out. And when you go to the bank sometimes with the mortgages, you expect that they are interlocutory, etcetera.

But what about situations where we have major corporations that provide completely different services, such as commercial banking and investment banking?

Could we then, you know, flip so that there is an opt in as opposed to just having the option to opt out? Because in those situations, the consumer does not maybe readily expect that they can go to their—pay their credit card bill or something with—at the same financial institution.

What would be your feel there?

Mr. ABERNATHY. Yeah, I think that goes into part of the whole parcel of issues that we are looking at in the context of this legislation. Obviously, there are debates taking place on these types of ways of presenting choices to consumers and other areas of legislation.

I think we need to keep first and foremost again in mind what is the goal that we are trying to achieve. The goal that we are trying to achieve is to provide the widest array of financial services to the most customers as possible at the lowest cost.

Now if we keep that in mind, together with the important goal of maintaining the security of their information, then we have some means of measuring where the one way of presenting choice to consumers is better than another choice, but we need to keep those particular goals in mind as we evaluate that.

Mr. MEEKS. And lastly, because I did not really—I did not hear your answer, I did not understand your answer, to Mr. Sander's question about what would be your recommendation when we talk about the uniform national privacy law and having the States making a determination as to whether or not they want to go to a standard that would make sense nationally. Because we may all agree that we should do something nationally.

What is your opinion on allowing the States to have a higher standard than we may have since had nationally?

Mr. ABERNATHY. Well, that is the very key issue I think that we are evaluating right now. We have been having an experiment now for seven years as to whether or not setting uniform standards at the federal level with regard to information sharing is the right answer to get to these—those goals that I mentioned to you. And now we have the opportunity to go back and see what are the results.

What has been the results in terms of providing services to customers at low cost and wide array? Has the current system worked best or are there some changes to it that might be better?

And that is the process that you are beginning today, that we have been undertaking. And at the end of the day, whatever the answer is, it has to be what is providing the best set of financial services to the customer as possible.

Mr. MEEKS. Thank you. I yield back.

Chairman BACHUS. Thank you, Mr. Meeks. Mr. Hensarling?

Mr. HENSARLING. Thank you, Mr. Chairman.

First, I feel compelled to set the record straight. And I regret that Ms. Maloney is no longer with us. She invoked the name of my dear friend and former employer, Senator Phil Gramm. I would like to say for the record that although he maintains an office in New York, I assure you that his home and heart remain in Texas.

Mr. Abernathy, in your testimony, you mentioned that since the FCRA experience with uniform national standards began we have witnessed significant increases in the availability of credit to Americans.

As a freshman congressman, FCRA is a matter of first impression to me, but I assume that there is at least from the evidence I have seen so far, a cause and effect relationship here.

And so, it was not evident to me in your testimony, do you believe there is a cause and effect relationship here?

Mr. ABERNATHY. There is certainly a high correlation. And the arguments that I have seen as to how you connect those dots are very compelling. I think really what the research that remains to be done is just what is the size, how big can you quantify that increased access to financial products through the FCRA?

But I think the trend is undeniable. I think the effect is undeniable. How big is it? I do not know, but it is big.

Mr. HENSARLING. So at least we have some historic analysis that underpins the belief that a uniform standard has increased greatly the availability of credit to Americans.

I am curious, have you reviewed any evidence? Or is there any other modern economy that you are presently aware of that has a contrasting system of consumer reporting? I believe the phrase patchwork has been used before. If so, have you compared and contrasted the system of that economic system with ours on the availability and cost of credit?

Mr. ABERNATHY. There are few countries in the world that have the kind of federal system that we have. Well, one of the great benefits that we have from our federal system is our dual banking system, which comes as a great consequence of our federal system.

But with regard to the availability of credit, really what the contrast is, is the—what you might call the full credit report system that we have, that provides positive information with regard to customers, as well as negative information. Haven't been paying your bills? That is on your credit report as well.

You can compare that with a number of other countries that only allow the placing of positive information and the negative information does not go on.

And it seems to be that when you make those comparisons, the cost of financial services is much lower here in the United States than in those countries. And the availability, the way we did—the people that we can reach with financial services is much greater in this country than it is in those countries.

And the variety of services, the kind of creativity that we have in this country for developing new financial services far exceeds anything else that you find in any other country.

Mr. HENSARLING. In your testimony, you also allude to a GAO report that says it can take victims of identity theft as much as 175 man hours to clear their names and records, 175 hours. So roughly the same amount of time it takes us to fill out our federal tax returns, but I suppose that is a matter for a different committee at a different time.

I have some familiarity with identity theft. Prior to becoming a congressman, I was a small businessman for 10 years. I employed fewer than 10 people, but one of those people decided to open up a credit card in the name of our small business, obviously without the knowledge of myself, the owner of the small business, and run up a tab of roughly $23,000, roughly equivalent to this individual's annual salary.

I am happy to report that once I became aware of this, frankly, with one letter to the credit card company and one telephone call to the credit card company, I never had to worry about this matter again. And the employee obviously had to deal with a felony theft conviction.

But I am curious about how often, from your experience, does the system work? The system worked for me unlike the people who have spent 175 man hours to clear their names and records.

Mr. ABERNATHY. It is uneven, congressman. I think where the best progress has been made has been with credit cards. Partly, it is because of federal legislation, partly because of a lot of the work that has been done by the credit card companies.

Under the Truth in Lending Act, a consumer today, a credit card holder is liable only for up to $50 for any unauthorized purchase that may occur on his credit card.

What the credit card company has discovered, and they opposed that piece of legislation, when it was put in place though, credit card companies lowered that number on their own to zero, because they discovered that by eliminating the liability for unauthorized purchases, they could greatly increase the willingness of people to use credit cards, knowing that by using a credit card, I am not opening myself up to an unacceptable level of risk that unauthorized purchases are going to take place.

And to back up that, once they went to a zero liability, the credit card companies did a lot of other things to try to reduce the costs that they were then taken upon themselves. And so, we have seen a lot of great progress that has been made with regard to—in the credit card companies.

Recently, a credit card company announced a program of offering insurance against identity theft. Not because there is a risk that you might have a loss for an unauthorized charge, but because as was pointed out I think by Mrs. Hooley, it costs a lot of money to clear your name and many victims.

175 hours, that is 175 man hours. That is a whole month, 40 hours a week of time stretched out over a long period of time, and usually involves very expensive legal costs.

Chairman BACHUS. All right, thank you. Thank you, Mr. Abernathy.

We are going to move to Mr. Moore. And I think at the end of his questioning, we probably will adjourn the committee for four votes on the floor. And we will convene shortly after those four votes, but it probably will be 45 minutes after we have recessed.

Mr. MOORE. Thank you, Mr. Secretary for your testimony.

Ms. Maloney asked you some questions. And you seemed to indicate that the Administration has not yet prepared to state a position or make recommendations to this committee, but I want to ask a couple of questions, coming at it from a different way, and see if you can help me with this.

Mr. ABERNATHY. Okay.

Mr. MOORE. FCRA's uniform national standards, which were enacted in 1996 were set to expire in January of next year, 2004. So we have now this committee and our committee, the full committee about eight months and the House, eight months to consider what is going to happen before the expiration on January 1st.

Are you able at this time to state, and maybe the answer is no, but I am going to ask anyway, are you able to state that you have any recommendations as to whether this experiment has been successful so far that we started in 1996 with uniform national standards?

Mr. ABERNATHY. I cannot give you complete answer because we have not completely reviewed all of the records.

Mr. MOORE. Then find me a partial answer if you can.

Mr. ABERNATHY. Well, I think the partial answer is, is that there is a lot of evidence that it has been very successful. There are some evidence or some assertions that are made that there are some problems that need to be worked on. We are looking at both of those, because when we bring our package or our suggestions to you, we want to make sure that they are the right answers, because it is very important that we get the right answer here.

Mr. MOORE. Everybody is concerned about privacy, right?

Mr. ABERNATHY. Yes, sir.

Mr. MOORE. And if, in fact, this experiment has worked for the most part well, I think a lot of us on this committee would agree that it should be extended. I am talking about uniform national standards?

Mr. ABERNATHY. Right.

Mr. MOORE. Okay? And in my experience as an attorney for 28 years, in many cases, the best answer does not always lie on either extreme, but somewhere in the middle. Will you agree with that as well?

Mr. ABERNATHY. That has been my experience of 20 years working in the Congress.

Mr. MOORE. All right. Are you aware, Mr. Secretary, of any other countries that have a system similar to ours or different than ours, that is better in your opinion, than ours as far gathering information for a credit report and extension of credit?

Mr. ABERNATHY. We are reviewing some of the other systems to see if there are some lessons to be learned. I do not think that that research has been extensive yet, although I know—and some members of the staff that are looking carefully at some of the examples of what there might be that we can learn from the European experience, for example.

It would be hard for me, though, to point to any country where I think it is better. Frankly, it is hard to find, and I do not know of any other country, where there is such a wide array of financial services available to the average consumer today, at as low a cost and to as many people. You know, we reach a much larger segment of the population than we ever did before.

Over the last 10 years or fewer, a lot of people that used to be on the fringe looking in to mainstream institutions are now their customers.

Mr. MOORE. I am not trying to beat a dead horse here. Not trying to push you say something you cannot say, but I would urge you and your other colleagues in the Administration to complete your study as quickly as possible, and provide that information and the recommendations for amendment or change.

And when we reauthorize this in January, before January of next year, so that we can take what needs—take what action needs to be done here in this committee and the full committee and the House floor.

Mr. ABERNATHY. Thank you. I appreciate that encouragement and will act on it.

Mr. MOORE. Thank you, sir, very much.

Chairman BACHUS. Thank you. We are going to recess the subcommittee until 12:30. We are going to reconvene at that time. Assistant Secretary, will be available at that time?

Mr. ABERNATHY. Yes, sir.

Chairman BACHUS. Okay, thank you. So we will adjourn until that time. Thank you.

[Recess.]

Chairman BACHUS. The subcommittee will come to order. Mr. Castle, if you have questions of the witness?

Mr. CASTLE. Thank you, Mr. Chairman.

Mr. Abernathy, this is a very hypothetical question. I do not want to get excited by what I am stating. And I am not even in support of what I am stating either, but I want to talk about national identification cards.

Mr. ABERNATHY. Okay.

Mr. CASTLE. Because I am interested in an objective opinion of what they might do with respect to preventing some of the piracy problems that you have concentrated on a lot today.

And I do not—I am not advocating them at all at this point, although I am not opposed or for them. And, obviously, as you know, a lot of people are opposed to them at this point.

But if we had national identification cards with biometric identification, I guess fingerprints or irises to the eyes or whatever it may be, and similar cards obviously for people coming to visit in the country, and obviously combined in some way or another with the computer abilities we have now in terms of identification of people trying to use credit cards or other methodologies of credit, will this be a way of addressing this problem?

Because I agree with you. I think this piracy is a huge issue, the ways on the minds of a lot of people across this country. And you are right, it is a huge aggravation. It can be $5.00 worth of goods and it can create all kinds of problems for you. And I am just casting about for ways to do this.

So I am not asking you to endorse national identification. I understand some of the politics of that, but I am just curious as to whether you have given any thought to how that might interact with the whole business of piracy and perhaps the prevention of piracy?

Mr. ABERNATHY. Yeah, there are a number of different ways of identifying who your customer is, so that you can be relatively comfortable in the bonafides that you are dealing with the person who you think you are dealing with. And I think technology is opening up some very interesting opportunities that might not have been there years ago. Biometrics with so many ideas, smart chip cards and things of that nature.

I think it might be a little bit too early yet to predict where the technology will take us. And one of the more significant problems that you often have as a policymaker is trying to make the policy match where the technology is, or even more importantly, where the technology is going, to make sure that you are not coming up with policies that have foreclosed opportunities that the technologies might present to you.

And I would like to think of it in terms of that—looking at the problem in that way, of making sure that we have legislation that does not foreclose the development of certain types of identifiers that technology might offer to us in the near future.

Mr. CASTLE. Well, I—that is a good answer and I would agree with you. And you know, I just happened to pick national identification cards. I do not care how it is done. But I really hope that the Administration will spend a portion of each day, not to tell you what to do with your days, perhaps Sunday off, in looking at technologies.

And you are right, we do not—we in Congress never should pass legislation that would foreclose the possibility of developing something along those lines. And, frankly, technology has changed so fast, that it may have to change in two years. And I understand all that.

Mr. ABERNATHY. Right.

Mr. CASTLE. But I just think we need to have a greater focus. It just seems to me it is too simple in this country to be able to get a card, to get a PIN number, to be able to copy a signature or whatever it may be, or use a computer in some way or another, and be able to really take somebody else's—if not their identity, at least their credit for a borrowed period of time, if you will.

And I just think it is going to worse and worse. I think your—you have documented that today. And I think we have to fire with fire with the—we have done with this currency in this country. And I just think we need to start doing it with some of the other things that we are doing within the reasonable cost basis level. So I was just interested in getting that point clarified.

Mr. Chairman, I yield back.

Chairman BACHUS. Thank you. Thank you, Mr. Sherman?

Mr. SHERMAN. Just a comment or two. First building on the gentleman's remarks, I think that we did not have a whole lot of privacy 200, 250 years ago when we all lived in small towns. And given technology, we may not have much privacy in the future. And that is why it is important for us to develop rules for government and rules for other institutions, so that whatever information they do have cannot be misused.

I know these hearings are focused on whether we should have a federal system of regulating credit agencies. And I just want to say that I think that is an outstanding idea.

There are those in the consumer protection movement who would think if we could just leave it to every city to pass its own ordinance, then there would be a few cities that would pass their dream ordinance, or a few states that would pass their dream statute.

But that would leave hundreds of millions or tens of millions of Americans in states where they pass laws that would be the worse nightmare of these consumer agencies.

It makes more sense for us to reach a national mean, because 100 million consumers with no protection and 100 million consumers with whatever you define to be great protection, is not nearly as good as 200 million consumers with good protection.

A national economy does not work if Berkeley gets to have its own financial services laws, much as I know they would like to. So I do not know if the witness has any comment, but I do not really have a question with a question mark.

Mr. ABERNATHY. Well, I would add maybe one observation to that. I think it is important for us to understand that we have an interest in the security of our information. But I have a certain interest in my neighbor's information.

And my neighbor has some interest in my information. And one of the metaphors I use for that, but I think it applies in their financial information, I have on my house my street number.

Now, I could think I do not know if I want everybody to know what my street number is. So I could take off my house to house number. But that would make it much harder for the emergency vehicle to find my neighbor's house if all of the houses along the street did not have street numbers on there, and they had to try to figure out which is Mrs. Jones, where we are supposed to go to.

And I think there are similar ways in which each of our pieces of our information are important in helping meet the services needs of one another.

Now that does not mean that we cannot make sure that the information travels in secure channels. I think we can do that, but I think we need to understand that our information also is important to our neighbors. And their information's important to us.

Mr. SHERMAN. And just building on that, when there is identity theft, or where there is fraud, where there is fraud on both the financial institution and some identity theft victim consumer, or whether it is just fraud against the financial institution itself, those are not the only parties damaged.

I am damaged because I go to get a car loan, and they have to charge me a quarter point more on the interest to take care of the rest of that.

And so, while it is possible to identify people who have a problem with the present system—because then you can say, "aha, but my score is unfair." If we did not have a system design to prevent financial institutions from being defrauded or not having all the information they need, our interest rates would be higher, our consumer credit would be less available.

It is pretty amazing that people who never see me face to face are willing to lend me $10,000 and give me a nice plastic card with the picture of the ocean on it.

And that relies upon a system that has some disadvantages, but it has some advantages as well. I yield back.

Mr. ABERNATHY. Thank you.

Chairman BACHUS. Thank you. Assistant Secretary, the average American moves every six years. And that is actually two-thirds higher rate than any other country. Does our national uniform credit system play any role in increasing the mobility of our labor force and the ability of a consumer to move from state to state while keeping affordable credit reputation and preserving their ability to access well, cheap capital?

Mr. ABERNATHY. Yeah, I think it has a tremendous impact. We have today, because of the information sharing systems in place, we have in essence today the ability to have portable reputations. Your reputation can travel with you. And to give an—I have seen that in my own family, how important that was.

I grew up, when I was a young child from age 1 to age 12 in south Florida. At age 12, my parents decided they were going to move. They did not move next door. They moved to western New York. And I saw how difficult it was for my parents to re-establish their reputations.

They had good credit reputations, good business reputations in south Florida. They had to rebuild all of that when they went to New York because the information was not portable at that time. This is in the late 1960s.

Other people now, I have many friends who have moved many times. And they can pick up their lives wherever the new place they move to. Almost right away there, they are fully integrated in the financial life of their new community.

Chairman BACHUS. Thank you.

At this time, if there are no other questions, I would ask that you get back to us as soon as possible on the Administration's proposals regarding both FCRA and identity theft.

Mr. ABERNATHY. I would be very happy to do that, Mr. Chairman.

Chairman BACHUS. Thank you.

Mr. ABERNATHY. Thank you.

Chairman BACHUS. With that, you are discharged. We very much appreciate your testimony. And it has been very helpful. Thank you.

At this time, we will go right to our second panel. At this time, I am going to recognize Representative Castle for an introduction.

Mr. CASTLE. Thank you very much, Mr. Chairman. It is my—I guess the correct word, it is my privilege to introduce our next witness, but really, it is a great pleasure because he is a good friend.

Mike Uffner, who appears before us today in his capacity as a member and a board member of the United States Chamber of Commerce and the CEO of Autoteam Delaware, which is in the automobile business, selling cars to members of Congress who cannot afford to—I am sorry that is not completely correct, but selling cars to people in Delaware.

He received his bachelors and masters degree from the University of Pennsylvania. And I am very pleased he decided to make Delaware his home. In addition to employing hundreds of people in Delaware, Mr. Uffner has been an active participant in Delaware's civic and charitable organizations, probably too numerous to mention, really, but particularly the Delaware chapter of the American Heart Association.

I look forward to his testimony about the real world benefits of the national credit reporting system, what it means to business owners. And he has some stories he can tell us and what it means to consumers.

So we thank him for volunteering his day to be here with the committee, as we endeavor to establish a sound policy on credit reporting.

Chairman BACHUS. Thank you. I am going to introduce the other members of the panel. We have Mr. Dean Sheaffer, vice President of Boscov's Incorporated on behalf of the National Retail Federation. And Mrs. Hart had wanted to be here to introduce you, but she is in a Check 21 meeting, legislation which she introduced.

Mr. Michael Turner, President and Senior Scholar, Information Policy Institute, we welcome you. Mr. Joel R. Reidenberg, Professor of law at Fordham University, thank you. Mr. Peter Swire, Professor of law, Ohio State University and Mr. Michael Staten, Director of Credit Research Center, Georgetown University.

And Mr. Swire, you are a Professor of law at the law school of Ohio State, is that correct? Okay, thank you.

We welcome you—all of you gentlemen. At this time, we will go starting with Mr. Uffner for any opening statements.

STATEMENT OF MICHAEL S. UFFNER, PRESIDENT, CHAIRMAN AND CEO, AUTOTEAM DELAWARE, ON BEHALF OF THE UNITED STATES CHAMBER OF COMMERCE

Mr. UFFNER. Thank you, Mr. Chairman.

Thank you, Governor Castle, for the warm introduction. Good afternoon, Mr. Chairman and distinguished members of the subcommittee. Thank you for inviting me to testify before you today. I commend you for your efforts to protect the nation's economy and for holding a hearing on this important issue.

My name is Michael Uffner. I am the President, Chairman and CEO of Audit Team Delaware. We are a regional automobile dealer. We are located in Wilmington, Delaware. We have customers throughout the region, including Delaware, Maryland, New Jersey and Pennsylvania.

I am here to speak with you today on behalf of the U.S. Chamber of Commerce. I became a member of the Board of Directors of the Chamber in 1998. I also serve as Chairman of the Chamber's public affairs committee, and am active in the Delaware state Chamber of commerce, where I formerly served as Chairman of the board.

The U.S. Chamber is the world's largest business federation, representing more than three million businesses and organizations of every size and in every industry sector and region of the country.

I would like to jump right into the practical side of this matter. I believe a failure to reauthorize the FCRA could adversely affect almost every industry sector in the economy.

In particular, a failure to reauthorize would significantly disrupt the country's credit markets, increasing interest rates, and reducing the availability of credit, and could cause major disruptions in the way that companies of all sizes and sectors interact with their customers.

In the economy that is two-thirds driven by consumer spending, this is not an issue that Congress can afford to ignore. For example, a multiplicity of credit rules across multiple states could wreak havoc on the credit industry and their customers, making it more difficult and expensive for consumers to obtain credit for everything from home and car loans, to student loans and credit cards.

Further, this does not affect only banks and their customers, but reduces the ability of entrepreneurs to start businesses and create jobs, impedes the ability of companies like ours to expand, and reduces consumer spending.

In short, a failure to reauthorize the uniform standards of the FCRA could cause significant problems throughout the economy, from manufacturing companies to everyday services that people simply take for granted, like utility service and shopping.

While my experience may be typical for an auto dealer or a small retailer, these issues cut across the business spectrum. For your convenience, therefore, I have included as an appendix to my written testimony a short description how a wide range of industries relies on the smooth and continued operation of the FCRA.

Prior to the enactment of the FCRA, there was little widespread credit availability or competition in the credit market. Today's consumers, however, enjoy more competition and convenience, because consumers who were formerly forced to obtain their car loans and own financing from their bank can now shop around for the most convenient and best deals.

These come from their auto retailer, their realtor, or even the bank across the country. For example in my industry, customers often had to shop around to a couple of different banks, wait a few days for approval, and compare financing packages that way. Now, they can obtain instant financing through us, through their own bank, or even through companies that may not even have offices in our state.

The customer benefits from these advantages. And the consumer will be the one to pay the price if a lack of uniformity increases costs and hassles. Because I come from the great State of Delaware, which incidentally, the U.S. Chamber recently rated as having the best legal system in the country, I am not particularly worried about any ill considered rules that my State legislature might impose on small businesses or on the credit reporting system.

However, my ability to conduct our business could be directly impacted if other states enact their own rules, even if I do not have any business relationships with those states. Different rules in different states may put consumers at a competitive disadvantages. Like many companies of all sizes, we generally operate on a regional basis, and have customers from four states. However, we occasionally do business with consumers from states as far away as West Virginia, Texas, and Florida, especially Florida.

For companies like mine who serve customers from multiple states, a uniform national standard is vital. Different credit rating and reliability standards in different states may affect my ability to serve customers in those states. And they force me to charge different prices for customers based solely upon where they live.

Second, a state law that reduces the information available in a credit report, making it less reliable, may force lenders to charge customers higher interest rates to compensate lenders for increased risks.

Finally, credit furnishers, companies that voluntarily provide information to their credit bureaus every month, could be impacted by the increased liability associated with different rules in different states.

This increased liability could impact upon their desire to report the proper information in a quick way. In a national economy that depends on interstate commerce, and allows consumers and businesses easy access to services in other states, a national uniform standard that treats every customer the same is vital.

Increased inefficiencies in costs could also adversely affect the primary job creator that our economy has, small businesses. For example, many entrepreneurs take out loans or borrow from their credit cards to start a company or sustain themselves during lean times.

If it is more difficult and expensive to obtain critical financing, many small business owners may decide that the costs are too great. Small businesses and consumers have been the drivers in this weakened economy. Let's not shut them down, now that the economy is just getting its legs back.

In our particular case, a failure to reauthorize could cause severe disruption in our ability to care for our customers. We have a corporate structure that is made up of separate, but affiliated firms. They are linked by common ownership and control, but perceived correctly by our customers as a single brand.

Restrictions on information sharing between these affiliated companies could turn a series of transactions that are seamless to our consumer into time consuming, multiple transactions. This could add to the hassle and stress to our customers, could increase the potential for errors, and could cause consumers to miss or forego potentially vital services.

Further, multiple transactions could actually increase the opportunities for identity theft if, for example, the number of people handling a single transaction increased from one to many.

In conclusion, the FCRA protects consumers, businesses, and the economy from potentially massive disruption. Without the preemptive provisions of the FCRA, a consumer's ability to borrow could face severe delays and burdens. Retailers' ability to provide seamless service to their customers would be at risk.

Borrowers could have their ability to establish credit impaired if lenders stopped reporting payment history to the credit bureaus. And companies that operate across state lines could be forced to charge different customers different amounts simply because the rules were different in the different states.

So, the current act helps me to meet the needs of my customers. If a customer needs financing at 8:30 at night, or on a Saturday afternoon, the current system provides me with the tools to complete the transaction quickly and efficiently, and to provide our customer with a competitive financing package.

If Congress allows these amendments to expire, the benefits of our national consumer credit system that have evolved over the last seven years will likely unravel. This potential patchwork of dozens of divergent laws and systems could result in significant detrimental consequences for consumers and businesses.

Again, thank you very much for the opportunity to present my experience to this committee. I would be happy to answer any questions.

[The prepared statement of Michael S. Uffner can be found on page 142 in the appendix.]

Chairman BACHUS. Thank you. Mr. Sheaffer?

STATEMENT OF DEAN SHEAFFER, VICE PRESIDENT OF CREDIT, BOSCOV'S INCORPORATED, ON BEHALF OF THE NATIONAL RETAIL FEDERATION

Mr. SHEAFFER. Good afternoon. My name is Dean Sheaffer. I am Senior Vice President of Credit and CRM for Boscov's Department stores and Chairman of the Pennsylvania Retailers Association. I am testifying today on behalf of the National Retail Federation.

I would like to thank Chairman Bachus and the ranking member Sanders for providing me with the opportunity to testify before the subcommittee. Boscov's is a family owned mid Atlantic department store chain. In addition to stores in Maryland, New Jersey, Delaware and New York, we have more than two dozen stores in our home State of Pennsylvania.

Boscov employs, more than 10,000 people. In 1911, Solomon Boscov established the first Boscov store in Reading, Pennsylvania. In those days, retailers granted store credit by word of mouth and the customer's good reputation.

As towns and cities grew——

Chairman BACHUS. Yes, if you would move your microphone a little closer. Thank you. Thank you, Mr. Sheaffer.

Mr. SHEAFFER. As towns and cities grew, retailers began using their local merchants associations as a trusted repository for information about the customers with whom they dealt. Eventually, the merchants associations were merged or sold, and became part of today's credit reporting system.

Boscov's currently has 1.1 million active credit card accounts. Activity on all our accounts, not just past due accounts, is reported monthly to the three major credit bureaus. As many of you know, consumers often use retail credit as their gateway into the larger credit market. It is very common for a Boscov's card to be the first credit card in a customer's wallet.

By building good credit with us, they help build a good credit file with the credit bureaus. This, in turn, makes them eligible for other credit products, such as car loans, or even a first mortgage.

I am here today to express strong support on behalf of Boscov's and the retail industry as a whole, for the permanent reauthorization of the seven state law preemptions contained in Section 624 of the Fair Credit Reporting Act. I want to briefly focus on three of the areas of the law that are particularly important to retailers: furnisher liability, pre-screening, and affiliate sharing.

Mr. Chairman, uniform standards and furnished liability are critical to the integrity and overall success of the current voluntary reporting system. Quite frankly, inconsistent or heightened liability standards, and the creation of new private rights of action would discourage lenders from supplying information, particularly negative information, out of fear of being sued.

Credit reports are only as good as the participants' information. If a creditor does not have a complete view of the consumers' information, their risk assessment may not be adequate. This incremental risk would then have to be factored into the loan, driving up the cost of credit, and diminishing credit availability. In the end, no one would benefit, except for lawyers.

Another important preemption under the FCRA is that for pre-screening. Retailers like Boscov's use pre-screening to grow our customer base. This is not just important to our credit card business. We use the same customer base as the best predictor of where to open a new store.

For us, it takes as many as 10,000 to 20,000 known customers to venture into a new location. Boscov's is still growing. Over the past few years, we have opened one or more stores in every state in which we do business.

If any mid Atlantic state were to act to prohibit pre-screening, they would undoubtedly slow down Boscov's entry into the new markets, potentially costing jobs and consumer opportunities.

Third, Mr. Chairman, in order to give our customers the service they expect, it absolutely necessitates information sharing among our affiliates, as well as with our third party licensees.

As a department store retailer, I would like to take a moment to explain the structure of our stores. When a customer walks into a Boscov's, they see a broad range of specialty departments, from make-up to fine jewelry. However, the Clinique and Lancome counters, for example, are not operated by Boscov's, but by Clinique and Lancome under third party license contractual agreements.

Additionally, a licensee company runs many of our fine jewelry counters. Boscov's also owns several retailing affiliates, including Boscov's travel center, our hearing aids center, and a warranty department that services the electronics and appliances that we sell.

Our in-house credit card is further maintained by corporate affiliates. This complex business structure is necessary for many valid, legal and accounting reasons. However, the structure is completely transparent to our customers.

Through information sharing with these entities, we cannot only market more specifically to our customers, and provide them with exceptional customer service, but we can also do things, such as underwrite more credit, and combat identity theft.

A lot of people have asked what affiliate sharing has to do with the granting of credit. And the answer is, a lot. Retailers use the data they collect from their stores and affiliates to create internal models that predict the credit habits of our customers. This information supplements credit reports and FICO scores to paint the most accurate picture possible of a customer.

In fact, retailers must often use this type of information to grant credit to people on the margins, in lower income households with mediocre FICO scores, or who are just entering the credit market. Information is also a retailer's best weapon against identity theft. As you know, this is one of the fastest growing crimes in the United States.

At Boscov's, we have implemented a number of safeguards to help protect our business and our customers, all of which require information sharing. Many retailers also have neural networks that identify suspicious purchasing behavior. Our systems will automatically flag transactions and refer them for investigation.

Further, as a service to our requesting customers who have been victims of identity theft, we program our register system to immediately refer sales made on their accounts to our credit center, to verify the customer's identity.

We at Boscov's are constantly challenged to find new patterns in our many data sources that will help us identify fraudulent transactions without inconveniencing our legitimate customers.

Without the ability to search all data sources available to us, ID theft would grow at an even greater rate. The ability to share, aggregate and search affiliate and third party data sources is paramount in the effort to protect Boscov's and our valued Boscov's customers.

In closing, I would again like to emphasize the retail industries strong support for the permanent reauthorization of the seven areas of State preemption.

In the final analysis, we in the retail industry have a real concern that more fragmented reporting and approval processes for credit will negatively impact consumers, and as a consequence, retail sales, ultimately costing jobs and hurting the economy as a whole.

Thank you again for the opportunity to testify here today. I look forward to working with all of the members of this committee to permanently reauthorize the FCRA preemptions before they expire on December 31st of this year.

[The prepared statement of Dean Sheaffer can be found on page 92 in the appendix.]

Chairman BACHUS. Thank you.

Mr. Turner?

STATEMENT OF MICHAEL TURNER, PRESIDENT AND SENIOR SCHOLAR, INFORMATION POLICY INSTITUTE

Mr. TURNER. Good afternoon, Mr. Chairman and honorable members of this subcommittee. I am grateful for the opportunity to testify before you today.

My name is Michael Turner and I am President and Senior Scholar at the Information Policy Institute, a non-profit, non-partisan research organization dedicated exclusively to issues pertaining to the regulation of information, both locally, federally, and globally.

Perhaps no information issue is more important on a day to day basis than the national credit reporting system. Currently, we are studying the significance of the federal regulatory framework, and related preemption that govern this system.

Preliminary findings from our analysis strongly suggest the national credit reporting system as governed by the Fair Credit Reporting Act, ensures that all consumers are given an equal opportunity to access credit, and with it, the opportunities that this access provides.

In addition, our data suggests that consumers have enjoyed a wide range of benefits directly attributable to the national credit reporting system. These consumer benefits are sizable and real, and would be put at risk should Congress fail to reauthorize the FCRA's strengthened preemptive provisions.

We have been examining how automated underwriting has impacted the cost of mortgage credit. In addition, we have been reviewing at a range of existing research in order to document how credit scoring and automated underwriting have affected access to mortgage credit, particularly for minority and low income borrowers.

Our analysis suggests that the use of credit scores and automated underwriting have played a key role in the dramatic expansion and access to mortgage credit witnessed over the past few years.

The institute is also conducting research to understand how the loss of full-file credit reporting may affect access to and the price of credit.

We have designed a number of scenarios showing how credit files could be affected with the loss of preemptions.

We constructed these scenarios based on pending state proposals. We are running the alternative-scenario credit files through a number of risk scoring models, determining the effect of the predictive power of the models, and comparing these results with the baseline from the current models.

We will also use these results to explore whether credit issuers would have to restrict access to credit to keep defaults at their current level, or, alternatively, accept higher default levels at the current levels of access.

The institute is also conducting research exploring the likely impact from a ban on the use of pre-screening. We are collecting data showing how credit-card issuers require new customers now, and how they would acquire them if pre-screening were prohibited.

Our study is not yet complete, but our preliminary results show that pre-screening is the single most important method of acquiring credit-card customers, accounting for about half of all new customers acquired.

Preliminary results also indicate that, on average, it is less expensive to acquire a customer using pre-screening. Further, we have good reason to believe that the loss of pre-screening would result in some loss of access from new-credit applicants.

Preliminary results from our study offer some indication that pre-screening may help to protect against identity theft. First, credit bureaus generally filter out accounts identified as being at high risk for fraud.

Second, card issuers typically review the application, using a variety of sophisticated authentication tools. These products are very successful, identifying as much as 80 percent of fraudulent applications before the accounts are ever opened.

Thus, a ban on pre-screening is unlikely to reduce the incidence of identity theft and may, ironically, have just the opposite effect. While we have yet to complete the quantitative component of this portion of our analysis, a survey of State bills is suggestive on its own.

During the current legislative session, there have been nearly 250 FCRA-related bills introduced in 46 states.

The diversity of these bills strongly suggests that a post-preemption world will not be characterized by legislative coordination and harmony among the States.

One possible near-term result is horizontal preemption.

As is likely to occur, should a single large state enact data restrictions inconsistent with the current FCRA regime, in a very real sense, then, Congress must decide whether it wishes to have its current authority over the national credit-reporting system usurped by lawmakers in a single state.

Mr. Chairman, thank you for the opportunity to testify, and I would be happy to answer any questions you and your colleagues may have.

[The prepared statement of Michael Turner can be found on page 130 in the appendix.]

Chairman BACHUS. Thank you. And Professor Reidenberg, it is my understanding that you have to leave at 1:50?

Mr. REIDENBERG. That is correct.

Chairman BACHUS. So you will be free to leave at that time, and we welcome your testimony.

STATEMENT OF JOEL R. REIDENBERG, PROFESSOR OF LAW, FORDHAM UNIVERSITY

Mr. REIDENBERG. Thank you, Mr. Chairman and members.

I would like first to commend you for convening this hearing on the national credit-reporting systems and would like to thank you for the honor and privilege to be able to testify today.

By way of background, I am a law Professor at Fordham University in New York, where I teach courses in information privacy.

As a law Professor, I have written and lectured extensively on the regulation of fair-information practices in the private sector, and my bibliography includes a series of scholarly articles and co-authored books on privacy.

I have also studied and written about the Fair Credit Reporting Act, and of particular relevance to today's hearing, I assisted the Federal Trade Commission in its successful litigation against TransUnion's illegal disclosure of credit-report information for marketing purposes.

I am testifying today, however, solely as an academic expert on data privacy, and I am not representing any organization or institution with which I am or have been affiliated.

I have a prepared statement for the Committee, and thought that I must highlight a couple of points from the Statement, and make a few recommendations, rather than go through all the details.

I will start, however, with a concern I have in hearing the testimony at today's hearings and some of the questions from the members concerning the current Fair Credit Reporting Act.

In particular, I am concerned by the terminology being used today: "Uniform national standard," and "reauthorization of the Fair Credit Report Act."

The terminology concerns me because I find those terms to be imprecise. Perhaps they are imprecise by design, but the effect of that imprecision is a very dangerous scare tactic for the development of good public policy.

The Fair Credit Reporting Act does not expire on January 1st. Only certain limited provisions related to federal preemption expire on that date.

As for the "uniform national standard," a term that we have heard used quite a bit this morning, it never existed, and it does not exist today. Prior to the enactment of the Fair Credit Reporting Act, two states, Massachusetts and New Mexico, already had credit-reporting statutes.

The current act, in fact, expressly authorizes three states to have standards that go beyond those preempted under the 1996 amendments. And, we have a series of States around the country that have stronger provisions on various areas of the statute that are not preempted by the provisions included in 1996.

So I think it is very important when the committee examines this issue, that the Committee focuses quite specifically on the exact alleged problems and exact harms and remedies that the statute is trying to resolve.

In looking at the statute, I think it is particularly important to review the history. Strong privacy protections are absolutely essential for the credit-reporting system in the United States.

The Fair Credit Reporting Act created the conditions for today's robust system. Congress in the 1960s heard extensive testimony on patterns of abuses. The statute introduced fairness and better accuracy.

The FCRA was novel in its time. The law created an opt-in approach for privacy. The statute defined core credit-reporting purposes, and authorized dissemination of credit information for those purposes. Anything else needed written consent.

Congress very wisely allowed the States to go further and to enact stronger protections. The 1996 amendments, as we have heard, contained a partial preemption clause. The amendments did not create a "uniform standard."

As the ranking member quoted from my prepared statement earlier this morning, when we look at the States exempted from the preemption clause, the three states that Congress allowed to go further, some preliminary data suggest that they do much better on credit decisions: They have lower bankruptcy rates. They have cheaper home-mortgage rates.

Strong privacy is absolutely essential for public confidence.

Looking at the statute, I think there are substantial weaknesses that threaten the safety and soundness of our credit reporting system.

The basic tenet for fair information practices enshrined in the original statute was that data collected for one purpose should not be used for other purposes without consent. Deviations from the key standard threaten the system. The 1996 amendments deviated from this key fairness principle in the affiliate-sharing and prescreening provisions.

Industry practices today are exploiting and circumventing the FCRA. Major wireless phone companies, for example, under the guise of offering credit, rummage through credit-reporting files, and instead offer free phones and free phone services.

Information dealers will sell the same data that is regulated under the FCRA outside the scope of the statute, because of the way the statute is drafted.

The kind of data leakage that is enabled by those provisions—the leakage of credit information for secondary uses of affiliate sharing, unsolicited offers, non-credit decisions undermine security. They undermine confidentiality and they facilitate identity theft.

In fact, Assistant Secretary Abernathy this morning mentioned dumpster diving in his testimony. When an identity thief goes dumpster diving, what is it they are likely to find in the trash?

All of those pre-approved offers of credit in the envelopes that people have thrown away. They give lots of valuable information for potential identity thieves.

Some of the issues we just heard in testimony on this panel were misleading. Pre-screening for instance, is not authorized under the statute for market research to decide where to locate stores.

We have to be very careful how we let data leak from the basic core credit-reporting functions.

I would like to make three recommendations for your consideration going forward. In essence, these all say that Congress must continue to assure the integrity of the credit-reporting system.

I think it would be particularly valuable first for Congress to legislate higher standards of privacy, to ensure the integrity and public trust by specifically returning pre-screened offers to the opt-in approach of the original FCRA, or else allow the States to legislate higher standards.

Let the preemption clause lapse January 1st, as you originally anticipated in 1996.

Second, expand the definition of consumer report in the statute to cover affiliate sharing. Or else, let the States modify that definition.

Third, extend the protections of the Fair Credit Reporting Act to the dissemination of personal information collected for the purpose of making any type of financial decision about the consumer, so that similar activities affecting consumers do not escape fair information practice standards.

In other words, these other organizations selling very similar information for critical decisions about consumers escape the protections of the statute. They should be brought within the statute. Thank you very much. I will be happy to answer any questions.

[The prepared statement of Joel R. Reidenberg can be found on page 85 in the appendix.]

Chairman BACHUS. Thank you. Mr. Swire?

STATEMENT OF PETER P. SWIRE, PROFESSOR OF LAW, MORITZ COLLEGE OF LAW, OHIO STATE UNIVERSITY

Mr. SWIRE. Yes, thank you, Mr. Chairman, ranking-member Sanders and other distinguished members of the committee.

My name is Peter Swire, and I thank you very much for the invitation to testify today.

I am currently a Professor of law at the Moritz College of Law of the Ohio State University. I live here in the D.C. area and am Director of the school's summer internship program.

As a Professor both of banking law and of privacy law, the area of financial privacy has long held special fascination for me, as odd as that might sound to normal human beings.

I have written four law-review articles in the book chapter just on the topic of financial privacy, and I will not be able to cover all of that in the five minutes here today. Thank goodness.

In March 1999, I was named as the chief counselor for privacy in the U.S. Office of Management and Budget, and in that position, I was intensively involved in the Administration policies during the Gramm-Leach-Bliley debates.

And as you know, President Clinton in the spring of 2000 proposed additional financial privacy legislation that was introduced in this committee as H.R. 4380, and that I think still can serve as a useful guidepost for some issues for today.

Since returning to law teaching, I have written a law-review article on my views on the Gramm-Leach-Bliley privacy provisions, and all of that is on my web site.

My written testimony, which goes into more length on several topics, largely agrees with the views of Mr. Abernathy and other witnesses on the overall tremendous effectiveness of the FCRA as a system for providing the advantages of price, speed and variety of products to the American consumers.

This has been a great success as a law which went into effect in 1970.

But I also think people involved in FCRA reforms should go back and read the hearings from the 1960s or read Professor Arthur Miller's book on the subject from the time, to see why we got this law, because I think some similar things are happening today in certain respects.

At that time, people's lives were being ruined by certain problems in the credit system. There were documented numerous stories of people being turned down for jobs and mortgages because of erroneous credit reports.

Because consumers have no direct relationship with credit-reporting agencies, there at that time was no effective way for the individuals to discover the mistakes and make the changes.

And in many instances, people would be turned down over and over again and never find out why.

As Professor Reidenberg just told us, the Fair Credit Reporting Act in 1970 created a legal system—opt-in consent, private rights of action, the FTC, the State attorneys journal—a series of strict and enforceable legal rules that changed all this.

Most central was that it changed accuracy in the system, because now consumers can see their own credit history.

In fact, industry fought that request for a long time, saying it was too burdensome to let individuals see their full credit history. We have gotten past that now at how keep improving accuracy is something that I think everyone has a great stake in.

So to sum up that history, an effective system of checks and balances that has been updated in 1996 with stronger consumer protections has helped create this great system we have today.

In my testimony, I make a number of observations about preemption and the FCRA. I am going to limit myself to one remark today.

Having heard the discussion, my question is whether identity theft efforts in the States should be preempted by Congress this year. This is a tough year. We know there is an awful lot going on in identity theft. We do not have all the answers yet. We hope the Administration will have its proposal in short order.

But as a basic matter, are we going to let the States experiment? We have, as Chairman Bachus said earlier today, a huge number of people suffering from identity theft in a lot of different ways.

It seems to be a natural subject for states to try to figure out how to do things, perhaps as they have helped figure out anti-spam legislation, and now Congress is learning from that.

There are several substantive matters that I touch on briefly in my testimony, and I am going to do it in one or two sentences here, issues to bring to the committee's attention.

One is an observation, again, that was made earlier this morning, that since 1989, there has been a tremendous increase in availability of credit to underserved populations, the lowest and second lowest quintile of incomes in the United States.

1989 perhaps coincidentally is when there started to be stricter enforcement of the Equal Credit Opportunity Act. This follows shortly after that by much stronger efforts in the community reinvestment area.

It is at least possible that underserved communities got some help from laws that came from this committee in these respects, and not simply from an earlier past credit reporting act.

A second point had to do with information security. In 1996, that was not on the horizon for how to improve the information security of critical infrastructure and the rest. It is on the front burner now. The Administration talks about information security in its testimony. There may well be measures to improve practices in that area, as you look at the law this year.

A third topic is medical privacy in the FCRA. The law was visionary for mentioning medical privacy in 1970, but it has not been amended in that respect since then. We now have a much fuller set of protections on the medical privacy area. This, too, probably deserves further attention.

And the fourth and final topic that Congresswoman Maloney mentioned earlier today, is some very disturbing language in the so-called PATRIOT 2 text that was widely circulated in town earlier this year.

As she described, there would be essentially no safeguards on sending credit reports in to government agencies basically without any limits on redisclosure.

For those who have followed the total-information awareness systems, where credit histories were something that was discussed there, we can see a system where credit reports get fed into the federal systems automatically.

How furnishers, how people in the system will feel about that in the world of voluntary compliance, is something, I think, that deserves attention.

In conclusion, my written testimony goes into more detail on this. A central question is how do we keep updating this information system for the information age?

Eight years ago, we did not talk about identity theft or information security. Eight years from now, there will be new information challenges.

However the committee looks to solve the problems for today, I hope we have a way to come back over time to update the protections for people in the system.

Thank you.

[The prepared statement of Peter P. Swire can be found on page 118 in the appendix.]

Chairman BACHUS. Mr. Staten, you are the third witness in a row from a University, from Georgetown University. We welcome you and your testimony.

STATEMENT OF MICHAEL STATEN, DIRECTOR, CREDIT RESEARCH CENTER, GEORGETOWN UNIVERSITY

Mr. STATEN. Thanks very much, Mr. Chairman and good afternoon to the members of the committee.

I am very pleased to be invited to join this discussion of the impact of the Fair Credit Reporting Act.

It is a remarkable piece of legislation that has facilitated the most robust credit reporting system in the world, a system that provides the foundation for the most competitive and robust credit markets on the planet.

By way of background, I am Professor of Management and Director of the Credit Research Center within the McDonough School of Business at Georgetown University. The center is a non-partisan academic-research center, devoted to the study of consumer-and mortgage-credit markets.

Over its 29 year history, the center has generated over 100 research studies and papers, many of which have been published in professional academic journals.

Many of these articles have directly addressed the evolution and value of credit-report data and credit scoring as a critical risk-management tool. We have watched the credit-reporting industry evolve under the FCRA, and we have closely studied the development and application of the risk-evaluation tools that credit reports make possible.

I should also note for the record that throughout its history, the center's research program has been supported by a mix of grants from the public sector, including the National Science Foundation and the Federal Trade Commission, as well as unrestricted private-sector grants from foundations and corporations made to the university on behalf of the center.

Because our projects so often address public-policy issues related to consumer credit markets, we are sensitive to concerns about our reliance on funding from industry sources.

For that reason, we established in 1974 and continue to rely on broad based external advisory panel of academic and government representatives, who provide independent oversight and commentary on all of our activities and projects.

Among that group, currently, are several distinguished Professors of finance and economics at major research universities, Senior Vice Presidents from the Federal Reserve Banks of Atlanta and

Chicago, and senior economists from the Federal Reserve Board of Governor staff right here in Washington.

By agreeing to serve in an advisory capacity, the reputations of these individuals become intertwined to some degree with the centers. Thus they have an incentive to be sure that our methodology is sound, and our conclusions are supported by the empirical evidence.

That structure, plus our continued placement of articles in high-quality peer-reviewed academic journals should diminish concerns that somehow our corporate sources of funding color our results.

This afternoon, I am pleased to share with you the results of two reports which I have recently co-authored to assess the impact of the FCRA.

One report was co-authored with my colleagues Fred Cate, Robert Litan and Peter Wallison, and was just published by the AEI Brookings Joint Center for Regulatory Studies.

The other report was commissioned by the Financial Services Coordinating Council, and it was co-authored with my colleague Fred Cate at the Indiana University School of Law.

I have summarized the highlights of both reports in my written testimony and will happily make the reports themselves available to the committee for your review.

Because there has been surprisingly little comprehensive study of the overall impact of credit reporting in the United States, our goal in both reports was to fill the gap, not by creating new estimates, but by surveying the business and economics literature to assemble evidence about the performance of the reporting system in regard to its original objective, which was to facilitate broad access to credit-related products for all consumers.

All of the relevant economic analyses, case studies, and government and industry reports that we examined pointed to one conclusion.

Underpinned by the most comprehensive credit reporting system in the world, the system of consumer-and mortgage-credit markets in the United States has achieved a remarkable combination of: one, widespread access to credit across the age and income spectrum; two, relatively low-interest rates on secured loans, such as autos and home loans; three, exceptionally broad access to open and unsecured lines of credit, such as bank credit card-products; and four, relatively low default rates across all types of consumer loans.

Achieving one or two of these results is relatively easy. Achieving all four simultaneously is an accomplishment unequaled in the rest of the world.

One of the strongest messages from the material we surveyed is that these benefits derive because we have evolved the national credit-reporting system, which in turn has facilitated a truly national market for all types of consumer loans.

Competition in every location, urban and rural, has been heightened because credit reports give lenders the confidence to reach out to consumers they have never seen, living hundreds or even thousands of miles away, and make them offers of credit.

Credit reports give consumers a portable reputation. That reputation brings them offers of credit from lenders they have never met. It travels with them across state lines, so they can obtain credit when they travel or move.

As a result, the vast majority of Americans deal with one or more creditors from out of State.

In turn, that out-of-state competition forces the local institutions to be just as competitive in pricing and product development. All of this lowers the cost of credit to U.S. consumers.

It is important to emphasize that it is not just the content of our credit reports that drives this result, but also the ability of institutions to use those reports across their affiliates to pre-screen customers and make them offers.

The ability to use credit reports to pre-screen customers is the jet engine that powered the explosion and competition over the past two decades. Credit reports provided the jet fuel.

Laws that would inhibit the assembly of comprehensive credit reports act as a barrier to that competition by denying new market entrants the information needed to provide new credit services.

In many European countries, where comprehensive credit reports are unavailable, and France and Spain are good examples, financial services are provided by far fewer institutions, and customers to a large degree are captive to the same institution for years.

It is no coincidence that also in those countries, consumer credit plays a far smaller role in the national economy and both unsecured and even secured loans are harder to obtain for those outside the upper tiers of the income distribution.

That is why proposals in this country to abandon the federal preemption enacted in 1996 under the FCRA threaten the diverse array of benefits that flow from the current credit-reporting system.

U.S. consumers are remarkably mobile, thanks in large part to the ubiquitous availability in credit reports. Regulating the content and uses of credit reports state by state would ill serve consumers as they move, commute and deal with businesses across state lines.

It will leave holes, and potentially large ones, in their credit files, which would greatly reduce the reliability of all credit reports.

A Balkanized credit-reporting system would make a consumer's credit worthiness, and credit opportunities, depend on the State in which he or she lived.

Thus the preservation of a truly national credit-reporting system is critical for sustaining and building on the remarkable record of the past 32 years under the FCRA.

As Congress deliberates whether to reauthorize the federal preemption, the risk of unraveling these remarkable gains to individual consumers should give members pause.

Thank you very much for the opportunity to testify today, and I would be happy to answer questions.

[The prepared statement of Michael Staten can be found on page 102 in the appendix.]

Chairman BACHUS. I thank all members of the panel for their testimony.

At this time, I am going to reserve my five minutes to allow other members who have been here time to ask questions. Mr. Royce?

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

I was going to ask Dr. Turner a question, and that was, if the seven provisions of the Fair Credit Reporting Act were allowed to expire, what information do you have concerning the effect that the legislative proposals that are put forward in the States would have on current reporting and information-sharing systems?

And I am thinking, for example, of California, my home state, has a proposal, which is Assembly Bill 800, which would dramatically alter, I think, the credit-reporting system, but only for California residents.

And it would allow a $2500 per violation fine for erroneous information, including typos.

And the question I wanted to ask was if you could provide your judgment concerning the likely impact of those changes, both individually and collectively.

Chairman BACHUS. Mr. Turner?

Mr. TURNER. Thank you, Congressman.

It is an excellent question, and it is very complex because, in fact, the relationship between the preemptive provisions and the robustness and richness of the credit reporting system is difficult to model.

What we have done is we have taken actual state proposals and categorized them, and constructed four different scenarios that we consider fairly likely should the strengthened preemptive provisions expire.

And these scenarios range from what we consider moderate or conservative, to more severe, and we have been working with modelers and analysts at credit bureaus and financial institutions to understand how this would affect particular data sets and then their ability to predict default, which is the primary objective of a risk model.

And we have not actually seen the results yet, but based on strong priors and our hypotheses, we expect that the ability to predict default will be deteriorated substantially.

And credit issuers would have one of two choices. Essentially, either they could preserve their current default rate, and to do that, they would most likely to restrict access to credit.

So, fewer people who are currently getting credit would get credit.

Or, they could keep the current level of access, but the cost of credit would be lost because charge-offs would likely go up. It becomes a riskier proposition.

Now this, of course, plays out through the credit markets generally, and it could have serious implications potentially for the safety and soundness of the entire system.

But, again, we expect to have the results back soon, and we look forward to being able to share them with this committee.

Mr. ROYCE. Thank you very much, Mr. Chairman.

Chairman BACHUS. Thank you. Mr. Sanders?

Mr. SANDERS. Actually, let me pick on Mr. Royce's questions to see if I understand. Do I understand, Mr. Royce, that in California, they are considering legislation which would fine some of the credit bureaus if there were mistakes found?

Mr. TURNER. $2500.

Mr. SANDERS. $2500? Okay.

I would gather, knowing this is the first that I have heard of that, that there is a reason that that legislation was proposed, and I gather there is concern about the number of mistakes that have been reported.

The issue here, and I want to address my opening remarks to Mr. Reidenberg, is it seems to me this committee should be doing two things.

First, we should have a national floor, a strong pro-consumer national floor, which among other things, does what six states in the country now do, and apparently the Administration is not unkindly disposed to this idea, to make sure that every citizen in this country at least once a year can get free access to their credit.

Six states now have that. I would like to see 50 states have that.

And I think in a number of ways, as the committee would want to deal with identity theft in as strong a way as we can, have a high national floor. That is one issue, and we will be arguing about what that means.

But the second issue then comes down to the question of States' rights and whether or not the folks in California or in Vermont or Alabama should also have rights to go forward in ways that they think can address the consumer concerns of the people in their own State.

Now from where I come, and what my political background is about, I think it is a really good idea. We can learn something from California. Maybe it will work, maybe it will not work. There must be a reason. Maybe these guys will get unelected if it is a bad idea.

But when we have 50 states and 50 Governors and 50 legislatures working on issues, whether it is identity theft or other issues, it seems to me there are a lot of good ideas out there that we would like to see germinate. What do you think about that?

Mr. REIDENBERG. I agree completely.

Mr. SANDERS. That is why we have you as a witness.

[Laughter.]

Mr. REIDENBERG. You took all the fun away.

On the national floor, that in fact has been the practice for almost all American privacy legislation. We can look at the different sectors in which Congress has enacted legislation. In HIPPA, in the Cable Communications Policy Act, the Video Privacy Protection Act, in each of these statutes, Congress has allowed to states to go further than the level the federal government set. That is the standard practice in the United States on privacy.

It is also the standard practice in other countries. If you look at what is going on in Europe, the European Directive, enacted in 1995, set a minimum standard for the European Union. Each of the member states had to adopt that minimum standard, but they could go further.

On the States' rights point, and from what we see in the different states, where certainly we have seen many interesting initiatives percolate up from the States in the privacy sphere, I think we will also find that there may be very local concerns in credit reporting coming from the States that we would not want to shut down.

An interesting example comes from your state, Congressman, a number of years ago, when I believe it was the entire town of Norwich, Vermont, found their credit reports all contained serious erroneous information because there was a particular problem that occurred in Vermont.

Mr. SANDERS. There is a slight problem. Those who paid their property taxes on time were told that they had not paid their property taxes at all. Other than that, it was no problem.

Mr. REIDENBERG. And if I may just make a point on the international side, because I mentioned the standard practice elsewhere. I think we have to be very, very careful making comparisons to other countries, which we have heard done I think in a very fast and loose manner during this hearing.

When you look at the credit industries and the granting of credit decisions in other places, those decisions are affected by far more than the privacy laws, and I will take the example of France, which was mentioned——

Mr. SANDERS. We do not talk about France here, sir.

[Laughter.]

Mr. REIDENBERG. Yes. We know.

We do know, for instance, that the French do not view the American dream the same way we do, and in France, where I have done substantial work on French data privacy—I hold a Ph.D. from the University of Paris in law—the suggestions that home ownership in France is a lower percentage than the United States, that the deposits one has to make to buy a home are higher because of the credit reporting system, those are extraordinarily creative uses of statistics.

The banking system is different there. Direct regulation of the credit relationship is different there. Foreclosure obstacles are substantially different there from the United States. All of those things factor in. You can not look just at the——

Mr. SANDERS. Mr. Reidenberg, I agree with that. But we do not have a whole lot of time. Let me throw it to somebody who has a different point of view.

Mr. Swire made a point a moment ago that it was not so many years ago that the credit bureaus opposed the right of people to even know what their credit was. We know that they have opposed free access to information. They now oppose the rights of States to go above the federal level.

Who wants to tell me why you think the world will collapse if the California legislature addresses what they see as a pro-consumer need? Or Vermont does the same? Who wants to tell me why that is just such a horrible, terrible idea?

Mr. STATEN. I will take a crack.

I am not going to claim the world is going to collapse, but let me describe to you a little bit more of the complexity of the reporting system.

First and foremost, it is a voluntary system. Nobody is required to report.

And because of that, that creates a certain fragility in the system, such that if you impose let's say excessive furnisher liability—and I do not know exactly wher liability becomes excessive, but at some point, clearly, we could have excessive furnisher liability—creditors could decide just not to report information that could trigger such a lawsuit.

What kind of errors in credit reports are likely to trigger such private rights of action? Probably negative information. So that might be the first thing that disappears from the credit files in those states that have passed those sorts of laws.

So you begin to lose the negative, so-called "derogatory," information in the credit file, which is the most important component for predicting future risk.

But it is more complicated than that. We are a very mobile society. It has been mentioned earlier, every American moves on average every six years.

So if Californians who live in that state, and for whom creditors now have not been reporting negative information for some period of time then move, they have holes in their credit files.

And a creditor that looks at them when they move to Texas or Georgia or some other state, does not know if a clean history is because they have really paid all their bills on time, or because they used to live in California and they simply can not see some of that negative information.

And so, the problem tends to perpetuate around the system, because we have a national credit system, and because we have a very mobile society.

And that is the root of the problem when you begin to let states do different things.

Mr. TURNER. Could I touch on that as well? I am sorry, because some of our analysis gets to that.

Chairman BACHUS. Go ahead and just briefly.

Mr. TURNER. And I think this, Congressman, should be of particular interest to you.

We are actually trying to retool models based on these alternative scenarios, and we have actually just gotten a credit bureau to agree to refit the models, based on proposals like the one, in fact, you recommend from California.

Mr. SANDERS. I did not recommend it. I just heard about it.

Mr. TURNER. Fair enough.

And it is a significant investment in terms of time to adjust to the data restrictions.

And imagine a scenario: We are only doing four, but imagine 50 states continually passing legislation. You have to continually then adjust 50 separate models to moving targets, at considerable expense and considerable time.

Now these models are based on sample sizes that are national currently, but if you go to a state, and particularly a small state with a small population, the predictive ability of smaller sample sets is diminished.

So for example, what you get is you get a small state/big state dichotomy. So in some senses then where you live determines your credit, and people in smaller states could be handicapped.

Mr. SANDERS. Let me just thank you for the extra time, Mr. Chairman. It is an interesting debate. I do not agree with the last two speakers, but I thank them very much for sharing their thoughts with us.

Chairman BACHUS. Thank you. Mr. Castle?

Mr. CASTLE. Thank you, Mr. Chairman.

I would like to address a question to Mr. Uffner and Mr. Sheaffer, in trying to understand the actual application of Fair Credit Reporting and what would happen if the preemption is removed, where the rubber meets the road at the retail level.

And I would assume that your experiences are quite different. I am not sure if Boscov's is nationwide or just the East Coast?

Mr. SHEAFFER. Just in the mid-Atlantic region.

Mr. CASTLE. Or mid-Atlantic region.

But one dealing with a smaller department-store type of transactions, the other with large automobile transactions.

For example, the case of Mr. Uffner, with all the zero-percent financing promotions on automobiles, etcetera, you know, is that something that could be done if we did not have some sort of immediate credit checks, and you had to go through several states?

Or just various questions about credit in general. I do not know if you recall what it was like before preemption or what you know about it, but I am sure you have probably monitored this to a degree, both of you, and what the costs would be, what the concerns would be, and just how it applies to those of us in the room who are trying to go get credit and buy something?

Mr. UFFNER. I will take a crack at this first.

From a practical standpoint, I can tell you from personal experience that before 1996, we very rarely would deliver a vehicle to someone, what we would call instantly.

We have clients that come in all the time now. About 50 percent of our clients will take delivery of a vehicle within two or three hours, the same day.

Whereas in the not so distant past, in order to get a credit decision from a finance source, which would be either a factory-finance source or a local bank, could in some instances take several days.

During that period of time, a lot of things happen, and vehicles that are set aside for people could get damaged. Or somebody else would try to buy it.

All I can tell you is that from a practical point of view, the transactions that take place in an automobile dealership today are significantly enhanced by the fact that we make reliable credit decisions very rapidly.

And we also do business in a lot of different states.

And we have real problems in some states with the titling laws that are completely different all across the country, and I know there has been some discussion about national titling, and that is not what we are here today for, but what affects us, and what affects the consumer and you as a consumer, is that there is significant additional costs in dealing with different titling laws in different states.

And we would look at it in the car business as this being a similar type of problem. If we had credit rules that were different 10 minutes away in New Jersey than we have in Wilmington, Delaware, then consumers from New Jersey would be at a disadvantage if the rules were severe enough.

So, this whole national preemption—and I am certainly not an academic expert, but maybe a practical one—really enhances our ability in this nation to affect the commerce in the automobile business.

Chairman BACHUS. Mr. Sheaffer?

Mr. SHEAFFER. Talking from retailer's perspective, I remember a point in time where retailers used to take a customer's driver's license and a major credit card—Visa, Mastercard—and rely upon those two pieces of information to issue a starter line of credit, typically $300.

In fact, Boscov's used to do this in the early and even up until the mid 1980s.

Once that card was issued, the retailer then had the obligation to try to go out and get the credit-bureau report as fast as they could, and to try to make a decision based on potentially non uniform data.

Two things happened. One is we made poor decisions in issuing that $300 line of credit. If a person were trying to defraud us, they would have instant access, to that relatively small but nonetheless real $300; that they would walk away with our merchandise.

The flip side of that is the customer may have been wanting to make a very large purchase, a $2,000 purchase of a large screen. Well, perhaps they did not have large-screen TVs then, but a $2,000 purchase in our store, and we would not be able to authorize that purchase instantaneously.

In today's world, because of the uniform standards, because we know what a current line of trade in the credit bureau means, because we know precisely what a FICO-risk score means, we can make very well-informed decisions.

96 to 98 percent of the decisions we make as a credit granter are good decisions. They are accounts that pay us on time, they are responsible consumers. We are acting as responsible credit granters.

If we Balkanize the credit system, and now in California, "current" means, well the customer paid us somewhere between one and 90 days, but in Delaware, it means the customer paid us between one and five days. I really do not know what a "current" credit line means anymore.

Scoring systems begin to deteriorate. My decisions deteriorate. My cost of credit goes up. My ability to grant credit diminishes. It affects the economy as a whole.

Mr. CASTLE. Thank you both, and I yield back to Mr. Chairman.

Chairman BACHUS. Thank you. Mr. Moore?

Mr. MOORE. Thank you, Mr. Chairman.

Mr. Staten, would you agree that California, in terms of the economy, the relative size of the economy is one of the biggest in our country?

Mr. STATEN. Absolutely.

Mr. MOORE. Okay. In fact, it is bigger than many nations around the world, isn't it?

Mr. STATEN. All but about what, seven or eight I think?

Mr. MOORE. Okay.

And if commercial entities want to operate in California, and California legislature adopts something more stringent than federal standards, they have to do it, don't they? Or just give up a large portion of a potential business. Is that correct?

Mr. STATEN. Anybody with a California presence would find it difficult to walk away from.

Mr. MOORE. Okay. In effect, could California then kind of set the standard for the rest of the country?

Mr. STATEN. I could certainly see it happening with respect to an issue such as this one.

Mr. MOORE. All right.

And I am not sure, and maybe Mr. Sanders has a different view, but I am not sure I would want that to happen for Kansas or for Vermont or any other state. Would you agree with that?

I am not asking Mr. Sanders, I am asking you, Mr. Staten.

Mr. STATEN. Well, I am a Virginia resident. So I suppose that I prefer to have Virginia laws bind me.

Mr. MOORE. All right. Okay.

We have experimented for about the last eight years with uniform national standards and preemption, and I think most of the people up here, who have testified today, most of the witnesses agree, that that deserves to be extended. There is one-and-a-half, maybe, exceptions there, but most of the panelists, I think, agree that it has worked pretty well overall.

I guess my question to you, Mr. Staten, and to anybody else who cares to comment is if it has worked well, if you agree with that, should it be extended on a permanent basis or on a five, seven or 10 year, something less than permanent where we can come back and reevaluate it once again in the future?

Do you want to start, Mr. Staten, please?

Mr. STATEN. Well, I certainly am in favor of extending it. It seems to me Congress always has the right to look at it again, at any point in time. So, whether it is the five year additional preemption or a permanent one, seems to make no difference in my view.

Mr. MOORE. You are going to agree with him, Mr. Swire?

Mr. SWIRE. I agree that these are national systems overwhelmingly. I think there is a lot of reasons to preempt, but there are two items.

One is that because of the expiration this year, this whole committee is taking this issue very, very seriously and really looking at a lot of things it might not have looked at otherwise.

And that fits the other laws we have seen—Gramm-Leach-Bliley and HIPPA and the Telecom Act—which is that privacy laws have been passed in this Congress when industry and consumer interests came together to favor legislation.

If you have permanent extension, you are not going to have that confluence, and you are really unlikely to get the reexamination, I think.

Mr. MOORE. Thank you. Anybody else care to comment?

Mr. SHEAFFER. I will jump in.

I believe that the permanent reauthorization is necessary. As stated before, you can certainly go back and look at it at any time.

But in 1996, as part of the overall negotiation process, we all agreed upon a test to determine whether or not state's preemption worked.

Indeed, the United States credit reporting system is effectively the holy grail of the world's credit reporting systems.

There is no better credit reporting system in the world. There is no reason not to extend it permanently, and again, you can always go back and look at it if technology or the environment changes.

Mr. MOORE. Mr. Uffner, any different thoughts?

Mr. UFFNER. Well, I really do not have any different thoughts. I really feel that if we have to change our rules in midstream, that it will create tremendous disruption, especially on a retail level amongst small businesses, medium-sized businesses, and I would hate to see that happen, especially when we are trying to get our economy back together again.

Mr. MOORE. Thank you, Mr. Chairman and panelists. Thank you as well.

Chairman BACHUS. Thank you. Mr. Tiberi, you are sort of an expert on this.

Mr. TIBERI. Yes, thank you, Mr. Chairman.

I did not give an opening statement, because I had hoped to have an opportunity to ask Mr. Abernathy a question, and that did not work out, but as you know, Mr. Lucas from Kentucky and I have sponsored a bill that not only extends FCRI but delves into the Gramm-Leach-Bliley issue.

And I appreciate you having this hearing today, and also the hearings that you are going to have in the future.

Mr. Turner, I am going to ask you a question I was going to ask Mr. Abernathy.

Section 507 of Gramm-Leach-Bliley, appears to authorize states to enact privacy laws that are more stringent than Gramm-Leach-Bliley, the Gramm-Leach-Bliley standard. Section 506(c) of the Gramm-Leach-Bliley Act also makes clear that Gramm-Leach-Bliley Act in no way modifies or supersedes FCRA and the Act's preemptions of State law.

What is your opinion, that you can give to us, on the interaction between Gramm-Leach-Bliley and the Fair Credit Reporting Act with regard to State laws on affiliate sharing?

Mr. TURNER. It is an excellent question. Unfortunately, it would have been probably better posed to Abernathy.

Our analysis does not look specifically at affiliate data sharing, nor does our analysis examine any relationship between Title V and GLDA and the strength in preemptive provisions in the FCRA.

We are really trying to measure the performance of the National Credit Reporting System over time, and as E.E. Schattschneider suggested that research is really finding the facts behind the facts.

We are trying to understand the causal relationships between the preemptive provisions and the performance, if any.

So unfortunately, that does not really speak to your question, but that is really the scope of our analysis.

Mr. TIBERI. Anybody else want to take a crack at that? Mr. Swire?

Mr. SWIRE. Well, the federal courts examined that—District of Columbia court—and I thought it was a convincing opinion that the judge wrote in that case, which basically found that the Gramm-Leach-Bliley provisions were effective, notwithstanding the claims that the FCRA prevented them from being affected.

Mr. TIBERI. Anybody else want to take a crack at that? No?

Let me switch to the issue of States here and the preemption of States, and Mr. Swire, I am an Ohio State graduate.

Mr. SWIRE. Oh.

Mr. TIBERI. So you and I are not going to be agreeing on this issue, but at least we agree on the Buckeye issue. You represent Columbus.

You made a statement in written testimony that standards under the FCRA are appropriate on a state-by-state basis because it will affect only those companies who choose to do business in each particular state, and your comments have been similar to that this afternoon.

Let me take it to another step here. As a state legislator, the issue of States preempting municipalities came up with respect to predatory lending. Can't we take this further and say, "Well, how about the municipalities that want to write their own laws with respect to this issue?" And what would you say to that?

Mr. SWIRE. Well, we have seen that, of course, in California with some of the Gramm-Leach-Bliley issues. I think that in my testimony I said the closer you get to how the computer systems you have to program nationwide, the more compelling the federal interest.

And the more it has to do with what kind of signage or what kind of local issues or what kind of personal interactions you have down at the local level, the stronger the local interest.

And if you are talking about how the programs are going to get reported into a national system, to me, that feels pretty national.

Mr. TIBERI. And following up on Mr. Moore's comments, doesn't it have the effect in essence, if you have Cleveland, Ohio and Los Angeles enacting stringent standards, stronger than maybe 40 other states, in essence, you have a national standard taking place that essentially could be controlled by a city council in Cleveland and a city council in Los Angeles, where Congress really is being usurped of its authority?

Mr. SWIRE. At some level, we have a history of State contract law being a local common-law, state-law effort. A lot of consumer laws get written at the State level. When this committee did Regal-Neil in 1994, they said the consumer-protection law stayed at a state level.

There is a very long tradition of that.

On the other side, if you are chopping up national computer systems with local exceptions, that is going to create a big mess, and so, I am just trying to make sense out of when does preemption makes sense.

The closer you have to a national system that you have reprogram, the stronger the argument for preemption.

Mr. TIBERI. Mr. Turner, do you want to comment on that same theory?

Mr. TURNER. Again, we see in the preliminary data a real risk. If there is a Balkanization of, for example, data-furnisher requirements or obligations or obsolescence rates, for example, for derogatories or you know, an increase in the reporting periods, it will have an impact on, again, the predictive power of the models, which will play out through the safety and soundness of the system.

So you know, obviously, we are talking about the difference between unified system versus a Balkanized state system.

If you extend that even further and allow counties or municipalities, you know, that problem increases exponentially. So I would not see that as a positive development in terms of consumer access to credit and the price of credit, and all of the benefits associated with those two variables.

Mr. TIBERI. Thank you. Mr. Chairman, just a comment.

It was talked earlier about credit bureaus providing credit reports. I would just like to note that my wife actually thought we had a credit problem, made a request to a credit bureau to get a copy of our credit, and we were provided a free credit report based upon the fact that there was a concern about our credit.

And I think that is done pretty uniformly across the country. Thanks, Mr. Chairman.

Chairman BACHUS. Do you think she had a credit problem because she was married to you?

Mr. TIBERI. Well, no, and it had nothing to do with the telemarketer either.

[Laughter.]

Chairman BACHUS. I appreciate that. Mr. Crowley?

Mr. CROWLEY. Thank you, Mr. Chairman.

Sorry I was not here for your testimony, but my able staff will make sure I get all your written statements, and I thank the Chairman for holding this hearing.

I have a general question for all of you, and then I have a second question specifically for Mr. Turner.

And the first question is, while I understand the need for information for a consumer to acquire credit, that would include any consumer's credit report that covers such things like their name, Social Security number, telephone, address, employment information, credit, and payment history, and other previous credit inquiries.

I am wondering what the law means by requiring one's personal characteristics and mode of living as criteria in regards to one's credit report.

And specifically, what do those last two terms mean as they are barely defined in U.S. Code 15 FCRA chapter of the U.S. Code, and how do they pertain to the core mission of the FCRA, which is to ensure easy and uniform availability of credit to U.S. citizens?

Mr. TURNER. My recollection is that the mode of living language has more to do with something called investigative credit reports, which were a much bigger deal back in the 1960s, where if someone was a doing a check on your credit, they might go interview your neighbors and do a whole background write-up on you.

And overwhelmingly, we have shifted away from that to a much more standardized system. So I think that is a much smaller piece than it was when the law was first passed.

Mr. CROWLEY. Well, this gets I guess to my second question then, and that is, there are these seven provisions that are in the law, and there has been discussion about parsing the seven privacy provisions that are all up for sunset at the end of this year.

And with some arguing that, as you have just made the argument, that maybe some are outmoded, and they be somewhat more important than others, could you rate the seven provisions in order of importance? Or do they in essence work in tandem, as for taking any one of them away would in effect changed the system of credit reporting?

Mr. TURNER. As I mentioned earlier, our analysis is not systematically examining the relationship between all of the provisions and the cost and benefits of the national system.

I have, through the process of conducting our research, come across this notion that several of preemptive provisions are for marketing, and the rest are for scoring.

And I just caution on this bifurcation, because the relationship between the preemptive provisions and either marketing or scoring is not necessarily linear and not necessarily intuitive.

For example, this notion that affiliate sharing is purely about marketing, in the work we are doing on identity theft, we have been having discussions with financial institutions, credit bureaus and the networks.

And we see that, in fact, the credit-card issuers interface with the networks in their neurological networks, and they rely on data from their affiliates to ascertain whether or not an identified incident of fraud is an isolated case, or is part of a crime ring.

And restrictions on affiliate data sharing, because perhaps it is considered a marketing preemptive provision, would in fact miss the greater context of the value of consumers of affiliate sharing.

And actually on that, I caution on this notion that consumer protections in the FCRA should be viewed narrowly through the privacy lens.

The ability of consumers to access credit, the ability of consumers to be rewarded for responsible behavior, for example, the de-averaging of credit that we have seen, because of risk modeling, and because of pre-screening frankly, could be lost.

And these are real consumer benefits, and these are real consumer protections.

So I think that when you are looking at the preemptive provisions, rather than ranking them, it would be far more beneficial to really understand the full context of each one, and that there may be scoring consequences or identity-theft consequences from these so-called marketing provisions that are not immediately understood.

Mr. SHEAFFER. Perhaps I could answer your question a little bit more directly, too.

As a retailer, I can tell you that every single one of the State's preemptions, if they were not extended and not reauthorized, would have a significant negative impact on my business.

And to expand on Mr. Turner's statements, in the retail business, we have many affiliates and unaffiliated companies under the Boscov's umbrella.

For example, there is the Boscov's Receivable Finance Corp., the Boscov's Credit Card Master Trust, and the Boscov's Travel Center. Some retailers have their dotcom operation as a separate affiliate structure.

We also have third party licensees: The Lancome counter, Clinique counter, the Ritz Camera Center in some of our stores, unaffiliated, contractually related third parties.

If we are unable to take and share data across those entities, I will do a much worse job of identifying identity theft, stopping identity theft, stopping credit-card fraud, protecting not only my business, but the customers, my customers in the communities in which I do business. This is absolutely critical.

Mr. SWIRE. Just one sentence. I said in my Statement today that I have come to think listening to the discussion today on preemption, a big issue is is the Congress going to preempt theft initiatives at the State level?

Are states just going to be put out of that business? Or do they have some role?

And I think figuring in to the overall preemption debate this year is something that deserves some careful attention.

Mr. CROWLEY. I thank you. Let me just thank the Chairman. I am in the middle of a mark-up over in the IR committee, but I appreciate this panel's testimony today. Thank you.

Chairman BACHUS. Thank you.

I would like unanimous consent to go ahead instead of going back and forth, for you two members to both question consecutively, and then I will close with either one.

Mr. FORD. Thank you. Thank you, Chairman.

If the ranking member in the committee, my friend Mr. Gutierrez, wants to yield to the leader, just a couple of quick questions, following up on the line of questions raised by my friend Joe Crowley.

I have concerns about these credit scores and the way there bureaus put this stuff together.

And the funny thing to me in this whole thing is that they do not really have any standards for putting stuff on the credit report, if it is bad, but they make you jump through about 50 hoops to reach them, let alone get the thing corrected, if they have made a mistake.

I just wanted to, for the record, one of these consumer federation groups, Consumer Federation of America, which does not always agree with me, but I agree with them more than they think I agree with them.

I think they are right on this—one of their more recent findings—or I should say I find interesting one of their more recent studies, where they get in to how two or three headaches—I would love to hear the panel's sort of observations on this.

The first is that there seem to be these widespread discrepancies amongst credit scores between or among the different agencies, and we know the impact that these credit scores now have on pricing for credit and insurance and utility service, employment, and housing, rental housing included.

And the numbers are just staggering here. If I could, Mr. Chairman, one of the findings in the study shows that the impact of credit-score discrepancies on at-risk consumers is really phenomenal.

So, roughly eight million consumers are likely to be misclassified as sub prime upon applying for a mortgage, based on the studies review of credit files for errors and inconsistencies.

This misclassification can require a bar to overpay by tens of thousands of dollars in interest payments over the life of a typical mortgage.

I like numbers. I do not understand all this language. To give you all a sense of what I am trying to say, is over the life of a 30 year, $150,000 mortgage, if they place you at a 9.84 sub-prime loan, you would pay some $317,000 in interest, compared to about $190,000 if the borrower could obtain at 6.5 percent prime loan, a difference of almost $125,000.

That is a lot of money to a lot of families and to a lot of people in this country. I know this Congress will take up tax-cut policy here in the coming days or say the coming hours.

I know Mr. Sanders touched on the idea of these free credit reports and making this a national bill, and I would imagine everybody on the panel here has an interest getting accurate credit scores, I should say, free reports and having their credit risk evaluated fairly and accurate.

What are your thoughts on the free report? I heard some answers, but I did not hear them all.

And two, what are your thoughts about there being a better mechanism for consumers to redress or to correct problems with furnishers, discredit that?

And three, with the impact that these credit scores have if it is a wide array of things here in the country, shouldn't consumers, and for that matter just regular people, have some idea about how this credit-score methodology is put together?

I think that is what Jill was getting at it, just a tad bit there, because we all can guess paying your bills on time, doing all those things, the smart things, but it would still be good to know, and it would probably eliminate some of the bad things that people think about credit-reporting agencies along the lines that maybe they, based on where you live, or what you look at, to where you may work, or where you may not work.

So it seemed to me to be in the long run, this would be good for the industry, good for lenders, good for their furnishers of credit scores and most important, good for consumers.

I would love to heard some observations. Again, my frustration, if it came across, is not directed at anybody at the panel. I, like some 50 million Americans, have had a personal experience with this and have had to go through one recently, as I tried to get my home refinanced.

And one of the reasons was because one credit agency had something bad on it and the other two did not. It was my luck that the lender picked the one with the bad stuff on it, the wrong stuff I should say. I ended having to walk back through to try to correct that.

What are your thoughts? Congress is going to struggle with this, but how do you see we redress this, and can national legislation help or hinder?

Mr. STATEN. I will take the first crack it.

You had a number of different things rolled into those observations and I sympathize and agree, in fact, with many of them.

As far as the CFA study on the errors or discrepancies and the implications for a credit score and price, I am not intimately familiar with that study, but my big recollection is that a good part of those discrepancies came from errors of omission, if you will.

In other words, information that was not present on some credit bureau files, but was on others for that same individual, and my only point there is that, you know, that is partly a fallout of our voluntary credit reporting system.

And I just hearken back to some of my earlier comments that if we take steps, either at the national or at the State or at the municipal level, that discourage voluntary reporting, those kinds of problems the CFA found are going to get worse.

Mr. FORD. What do you mean by that? I am little a confused.

Mr. STATEN. Because there may be more errors of omission in the sense that good trade lines may not get reported. Negative may not get reported, and there may be essentially more holes relative to the true picture of the consumer that are present in the credit file because information simply is not being reported.

All right? In terms of the second comment, should consumers play a more active role in trying to do their part to police the quality of information in the credit files? Absolutely. I am all for that. That was the linchpin of the FCRA at the outset, giving consumers the right to access those credit reports.

Whether that means that they should have one free copy per year, I do not know. I do not really have a position on that, but I am all for anything that will encourage them to be using that and viewing it, and getting back to bureaus when they perceive that there are errors.

Mr. FORD. I could not agree more with everything you said, but what happens when you find there is a mistake on it or an error, and it takes you forever to try to get the doggone thing fixed?

And by the time you get it fixed, the lender's already made a negative decision. That is the challenge that so many, as you well know, of your customers or consumers and others face, and that is the concern I have.

I can understand mistakes being made. We make them here hourly. The way you correct it here is every two years, people go to the polls and vote. I want to know how do you expect the consumer going up against a large lender—and the lender's basing their decision on what they think is accurate information from a credit agency—what steps can be taken?

And maybe you do not want to propose, you know, regulation of credit reporting agencies, but how much can you do going up against your banker if the banker says, "Look, this is what we got from your credit report."

Mr. SWIRE. You have more rights than you used to because the FCRA exists.

Mr. FORD. You don't have any gripe on me there.

Mr. SWIRE. Right. But here are two observations.

One is, if Congress decides it is going to be a national law, and the States are out of the business here, then it is up to Congress to figure out these consumer protections. There is no one else to point to. So that is part of the work for this committee.

And the second point is, I have heard of a problem where a consumer goes in, corrects the mistake, but then the bad data comes back in a second time.

And I think that is an area that deserves special attention, maybe some additional hearings just on how that gets fixed, having the bad data come back in once it is been fixed the first time.

Mr. FORD. No, I am not shirking our responsibility. I just want to know your recommendation to us, because I have to think if we do something wrong, you are going to come back and tell us. So you might as well as tell us on the front end what we should do to make it right.

So I know I am going over my time, and I hope we can take Mr. Swire's advice, Chairman, and maybe even hold another hearing on these things. I know Mr. Gutierrez has expressed some concerns in this area as well.

Chairman BACHUS. Mr. Ford, we will just give you one minute instead of five minutes next time.

[Laughter.]

The gentleman from Illinois?

Mr. GUTIERREZ. Thank you, Mr. Chairman.

Well, I want to follow up on Mr. Crowley and Mr. Ford and the issues that they were speaking to. Because it seems that about 70 percent of credit reports have some kind of mistake on them, and three out of 10 have such a significant mistake, that it can actually impact.

I know a lot of us like to go out there and say APR and what that is, and what that means, and if does not mean anything else, it means the best rate for those people that have the best scores.

Everyone should walk into a mortgage company or a car dealership and get the best score.

So we know there are lot of mistakes being made, and we know they can be simply made.

And we know that insurance companies, at least it has been my experience that credit-card companies, even when you pay them the annual fee and you tell them that somebody double charged you, they seem to go into this new interrogation—"Well, you sure you were not at that hotel? Are you sure you didn't stay there? You didn't order that room service?"—to the point where you can feel like they are not on your side, and they are supposed to be protecting your interests.

And given this new phenomenon of these lack of any kind of personal relationship or real caring from the credit-card industry as I have seen it, and the credit industry in general and maximizing their profits.

The FCRA does not specifically address a reference-insurance score, so I would like if Mr. Swire could talk a little bit about insurance score.

So, if they are using your credit report in order to see whether or not you are going to have any insurance, how long, what your rate is going to be. So if I paid my Discover card on time for five years, and my mortgage, does that necessarily mean that I am going to get the best insurance rate? Can I make that assumption?

And conversely, are there things that my insurance report says about me that have nothing to do because I never violated a law in 10 years. I am a perfect driver. I pay my bills late, but I drive perfectly.

I imagine those people exist. I drive perfect. I have never been in any accidents, no traffic tickets. I mean, that has happened to me personally since I got elected in 1992. I have not gotten stopped or been issued a police traffic violation.

I mean some might say that is because I am from Chicago, but I like to say I have been much more careful about the way I drive. So I guess the question is, do your credit scores enhance necessarily how well you do in getting an insurance policy?

And if I drive real well, but I have a bad credit, can I get a lousy insurance rate?

And do we know enough about how they acquire that insurance score? Do we know enough of what the elements are? And should there be some more transparency in how we arrive at those? And would that help consumers?

Mr. Swire?

Mr. SWIRE. I have heard about the practice. I have not been in pure discussions about it.

The question for the insurance company is that they think that they can price more accurately, based on a set of information. As a business, they are tempted to price more accurately, and if they find out from experience folks do not pay their home premiums as quickly, then they are going to be tempted not to charge.

One of the problems is it exacerbates mistakes. Right? If there is a mistake in your file, or if there are reasons why your community gets treated badly on some score or there is any other problems in the system, as you link the system 12 different ways, that problem keeps going on all the way through.

One thing I mentioned earlier is, there are interactions for things like Community Reinvestment Act and Underserved Communities and a whole list of other areas.

And I think that those are things to watch for as these systems get linked together.

Because one apparently innocent factor could turn out to be used to disadvantage people a lot of other places.

Mr. GUTIERREZ. So we do not have a lot of information then, about how—because now that they are all interrelated, the people that give you credit, sell you the insurance, and give you the mortgage and everything else and the credit card—in order for me to establish my policy, the duration, and the premiums on my policy, we might—any members of the panel, do we know anything about the insurance industry using credit reports to reach decisions about what my premiums might be?

Mr. STATEN. I know that it is done. I know that it has actually been a growth product for the scorecard builders, these companies that build the models, like Fair Isaac in California, and I know that many of the leading property-casualty insurers do use them.

And the reason they use them is much as Peter said, they found that it is predictive of risk in the auto-claim area.

And so, like any good business, if you are worried about the competition, you are worried about other carriers stealing away your better risks, your better customers, if you can find a way to price them less, because you can reward them, then you would lower the price.

And you would gain more customers or you would keep customers from defecting.

By the same token, some people are going to get priced higher as a result, and I do not have a particular problem with that, although it is a bit of a mystery as to why your payment performance influences your driving risk, but it apparently does.

Peter's comment is well taken here, though, and that is that if there are errors, it is not just affecting the credit markets, but it is spread to the insurance market as well.

Mr. GUTIERREZ. Mr. Chairman, having driven a cab for three years, I paid all my bills on time, but you can imagine what my driving record was like.

And conversely, now that I no longer drive a cab, it has gotten better, and I would like to make sure that the public is getting a good break, a fair break, and that the information is such that they can challenge that information about how they get insurance premium.

Maybe we should look a little bit better into that.

And I think it stresses the point about, you know, these kind of impersonal institutions, when you have an 800 number for a credit-card company versus a lender that gives you a mortgage.

And I know Mr. Ford, the closer you get to home to those financial institutions, savings and loans and banks, the easier it is to resolve those problems, because you get a human being on the line that really wants to make sure that mortgages are handed out in that particular community, and it is really looking to do that.

Thank you very much, Mr. Chairman. You have been very, very generous with both Mr. Ford and I in extending this conversation.

Chairman BACHUS. Thank you.

Mr. GUTIERREZ. Thank you.

Chairman BACHUS. Mr. Uffner, could you explain how an individual might qualify for an auto loan if they were from a state that allowed robust credit reporting, might not quality for a loan, or may have to pay a higher rate if they are from a state that puts restrictions or limitations on credit history?

Mr. UFFNER. Well, from a practical standpoint, if a consumer comes in to purchase a vehicle, whether it is new or used, we are not the ones that make the credit decision.

However, we do use the information from the credit granters in order to make a determination as to whether or not we should deliver the automobile to this particular client.

So if we have a situation where we can not get a decision or that the decision that comes down from the bank or finance company is not as favorable, then that person would have to pay more for his or her credit.

It would not affect the price of the vehicle, but it would affect the price of the credit that they receive.

So anything that would interfere with the ability of the ultimate credit granters to make those decisions on a timely basis is, I think, is likely to increase the costs of those decisions.

Did I address your question, sir?

Chairman BACHUS. Yes, thank you.

Mr. Sheaffer, you have three stores in Delaware. You have three in New York. You have a couple of dozen in Pennsylvania. So I suppose it would not be too much for you to be aware, maybe, of the laws in those states.

But now you are both a furnisher and a user of credit information?

Mr. SHEAFFER. That is correct.

Chairman BACHUS. If we had 50 different laws out there, how might that impact you with regard to furnishing credit information or in using credit information? What would the cost of that be?

Mr. SHEAFFER. I do not know that I can give you a hard-dollar cost, but I can tell you how it would affect us.

Chairman BACHUS. Right.

Mr. SHEAFFER. For example, if there are 50 different laws, on what information I could report, at what point in time I could report that information, or if there were different standards of furnisher liability throughout all 50 states, I would have to make a business decision whether or not, again on a voluntary basis, I wanted to report information on my customers in that given state.

For those states that I chose not to report credit information, the credit report will be less complete. Therefore, my fellow credit granters would be able to make less accurate future credit decisions.

The same is true as a user of credit information. If for each individual state in which I did business, I would have to have an entirely different process, an entirely different set of business rules, not only about who are individuals to whom I grant credit, the credit scores bring out different things for different states.

I would also have to create different processes for credit-limit assignment, account management, collections, charge-off and recovery potentially, because I now have more or less predictive information about how to handle an account throughout its entire life cycle.

So it is not just an issue of initial underwriting, it is an issue of account management throughout the life cycle.

Chairman BACHUS. You know, I would think that with some of those states who may impose a higher limit, obviously you could have the unscrupulous take advantage of those in several different ways. Could it encourage people to move from state to state?

Mr. SHEAFFER. Well, not only could it encourage people to move from state to state, it almost might prevent folks from living from state to state. For example, if Maryland, hypothetically, had a standard that said an issuer was not allowed to report credit information for 90 days, and Pennsylvania has a provision that said you may report it in five days, I may not, as a Maryland resident, if I have been sort of past due, and my credit availability has still been there, and I am thinking about taking a new job in Pennsylvania, I may make the decision not to do that because I know that just by virtue of moving to a different state, my Visa card or my Boscov's charge will be past due; or, I am sorry, will be closed, or my credit limit will be reduced. Or, perhaps I will not be able to get a mortgage in the States that now have more robust credit reporting law.

Chairman BACHUS. Thank you. We have a vote on the floor. And I think we have about five minutes left. So we are going to discharge the committee at this time. But Mr. Turner, I would ask you, you mentioned some interesting work that you have done that I think could helpful for us to consider on the issue.

But would you be willing work with the GAO, so that they can maybe understand your research, and help us evaluate it? We understand that the data would be subject to confidentiality restrictions and GAO would have to respect those, but if you would work with the GAO, it would be quite helpful to us to submit some of your——

Mr. TURNER. To the extent that they are willing to respect the confidentiality agreements, I would welcome the opportunity.

Chairman BACHUS. Thank you. At this time, the hearing is—Mr. Crowley, I do not know if we have time.

Mr. CROWLEY. Mr. Chairman——

Chairman BACHUS. Go ahead.

Mr. CROWLEY.——my quick point, and that is, Mr. Sheaffer, you actually answered my question. I was going to ask on uniformity. For instance, late payments, for instance, varying from state to state. We obviously have until the sun set. And you have answered my question. I thank the chair.

Chairman BACHUS. And I apologize. Thank you.

This hearing is adjourned.

[Whereupon, at 2:32 p.m., the subcommittee was adjourned.]

A P P E N D I X

May 8, 2003

STATEMENT OF CHAIRMAN SPENCER BACHUS
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
"THE IMPORTANCE OF THE NATIONAL CREDIT REPORTING SYSTEM TO CONSUMERS AND THE U.S. ECONOMY"

Good morning. The subcommittee will come to order. Last week Chairman Oxley and Ranking Member Frank jointly announced their intention to hold a series of hearings with respect to the Fair Credit Reporting Act. Because key provisions of FCRA, which are of critical importance to consumers, will expire at the end of this year, they agreed to work together to develop bipartisan legislation. This first hearing will focus on the importance of the national credit reporting system to consumers and the U.S. economy. Additional hearings will take place over the next two months and will cover a full range of issues relating to the national credit reporting system and the security of consumers' personal financial information.

I am pleased that the Chairman and Ranking member have made FCRA a top priority and look forward to working with them on this important issue. I expect that our efforts will culminate in legislation since key provisions of the Fair Credit Reporting Act are set to expire at the end of the year.

The U.S. economy is being supported to a great degree by consumer spending. In fact, consumer spending is vital to the strength of the economy. A critical component of consumer spending is the availability of consumer credit. For example, many major purchases, such as homes, cars, appliances, college educations, and vacations, are financed using credit. However, we tend to take for granted the national credit reporting system that enables this credit to be extended safely and efficiently. In fact, it is our national credit reporting system that provides a great deal of fuel to the engine of consumer spending that is currently driving our economy.

Although many strong market forces have helped shape our credit reporting system over the years, the contours of the system were fundamentally defined by the basic legal framework established under the Fair Credit Reporting Act, or "FCRA." Congress adopted the FCRA in 1970. The law was passed because the banking system and consumers depend on fair and accurate credit reporting, and Congress wanted to ensure that credit bureaus exercised their important responsibilities with fairness, impartiality, and a respect for the consumer's needs. Congress made some significant amendments to the FCRA in 1996 to improve the FCRA's consumer protections and to "update" the FCRA to better accommodate the needs of lenders, consumers, and others.

At its core, the FCRA is a consumer protection statute which regulates the credit reporting process. In order to protect the consumer, the FCRA imposes important and strict obligations on those who provide information to credit bureaus, the credit bureaus themselves, and those who receive a consumer's credit report. The FCRA also severely limits who may see a consumer's credit report, allows consumers to access their credit report, and provides a mechanism under which consumers can dispute the accuracy of anything in their credit file (such as when the consumer is a victim of identity theft).

In view of the FCRA's core function of regulating the credit reporting process for the benefit of the consumer, we will hear in detail today how our uniform credit system under the FCRA benefits consumers and the economy as a whole. Among the consumer benefits afforded by our national credit system are efficient and convenient access to credit and insurance, strong competition in the financial services marketplace, and lower costs of credit.

Although I just mentioned the benefits our national credit system provides for consumers in the financial services sector, the scope of our national credit system is much broader than one industry. For example, today we will hear from two private sector witnesses as they discuss how the FCRA is important to consumers with respect to other sectors of the economy, such as retail and automobile sales. Although we will hear the perspective given from a retailer and from an auto dealer, the subcommittee could have just as easily asked a wireless telephone provider, a utility company, a day care center, a university, or dozens of others to describe how the FCRA is important to consumers with respect to their businesses.

Several witnesses today will also describe a critical component of the FCRA's, and our national credit system's, overall success—national uniformity with respect to several areas of the law. The national uniformity provided under the FCRA ensures that consumers have access to affordable credit in all fifty states, minimizes red tape, and helps prevent identity theft and fraud. I would also like to remind the subcommittee of the testimony provided by the Federal Reserve Board Chairman, Alan Greenspan, to the House Financial Services Committee just last week. When asked about the importance of the FCRA's national standards for our credit system, he responded, and I quote, "I've been in favor of national standards here for reasons which are technically required. If you have very significant differences state by state, it would be very hard to maintain as viable a system as we currently have."

The provisions in the FCRA that guarantee a single national standard with respect to many of the FCRA's provisions are set to expire on January 1, 2004. I share Chairman Greenspan's concern that if we have different FCRA requirements among the states, the consumer benefits and protections provided by our national system could be destroyed. I am extremely concerned as to how a patchwork of state laws may affect the cost and availability of credit, and therefore the economy as a whole.

I again thank Chairman Oxley and Ranking Member Frank for working together to move this difficult issue forward. I encourage all Members of the Subcommittee, both Republican and Democrat, to follow their example as we address FCRA reform.

The chair now recognizes the Ranking Member of the Subcommittee, Mr. Sanders, for any opening statement he would like to make.

Statement of Congressman Vito J. Fossella before the Financial Services Committee, Financial Institutions Subcommittee
May 8, 2003

Mr. Chairman, I want to thank you for arranging this hearing today and appreciate the fact that you have intentions of more hearings regarding the Fair Credit Reporting Act (FCRA).

The Fair Credit Reporting Act has been, in my mind, one of the most beneficial acts that Congress passed which allows for the secured, free flow of information between companies and their affiliates which is what has opened the doors to people of all walks of life and especially low income and minorities. I also happen to believe that FCRA is what opened the floodgates of locked up capitol trying to find its way into the market. As we all know, much of that capital was directed towards the housing market which has been a driving force of our economy, and I doubt there is one person in the room that can say they don't know some family member or friend whose job is not dependent on the housing market.

This morning I came into the office and one of my staff was telling me that she had just refinanced her mortgage which will result in a savings of around $200 a month. As it turns out, she was able to refinance her entire mortgage over the internet and didn't have any contact with another person until someone from the title company came over to her house so her an her husband could sign the papers.

Breaking down the process further, this example shows how the Fair Credit Reporting Act, in its current form, benefited the consumer. First, a company was able to check a homeowner's credit report to see if they would be eligible for a low interest mortgage loan. Second, the company was able to contact the homeowner via email and notify them that they may be eligible for a mortgage at a lower interest rate than they are currently paying. Now the homeowner was in the position to make a choice whether or not they wanted to refinance. Upon deciding that it might be worth looking into, they submitted additional information to the company; what their loan amount was, what the interest rate was, how much they were willing to pay down up front etc. etc. This gave the company the ability to run the numbers and see if they could resell the loan to a mortgage company, all in less than twenty-four hours. When the homeowner received the offer, they were able to reach out to a few other banks, some over the Internet and others through personal contact, all having to go through the same steps as the first and giving them an offer almost immediately. After reviewing all of their options, this particular couple found their first offer to be their best offer which led them to finished the online process. About a week later a representative from the title company came to their house and they signed the papers.

As you can see, this was a tremendous benefit to the family who is now saving more than $200 a month that can be directed towards groceries, investments, a car, or maybe an education account for their children. Either way, the family has saved money due to the highest level of competition seen in the mortgage industry in years.

These are the good things that FCRA has brought us. But we would be irresponsible to ignore some of the bad things that have resulted as more people have gained access to credit accounts.

There are a number of issues that will need to be addressed, maybe not right now, but soon, regarding the procedures to be followed when personal financial information is stolen from an individual. Whether or not we address this in the reauthorization of the FCRA pre-emptive amendments is still to be decided, however it will need to be addressed with the intent to protect the consumer, while not limiting their ability to receive such offers as I have discussed.

I also happen to believe that the judicial system needs to be more involved in the enforcement of abuses. This is an issue that should be addressed at the ground level, the $500, $1000 or $5000 criminals is where prosecution needs to take place.

In some cases, individuals committing identity and financial information theft are half way across the country and sometime halfway across the world. However, our courts do not have the resources to fly someone from California to Staten Island for a court hearing. There needs to be a better system in place and I hope that as we continue to investigate this issue, we will find a way to better serve and protect the victims of these crimes.

May 8, 2003

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit Hearing entitled, "The Importance of the National Credit Reporting System to Consumers and the US Economy."

Thank you, Mr. Chairman, for holding this hearing and for your leadership on this issue. Ensuring a uniform national standard for consumer protections governing credit transactions is one of the most important tasks this committee will face in the 108th Congress.

On January 1, 2004, these standards as established in the Fair Credit Reporting Act (FCRA) will expire and states will again have the ability to enact differing regulations. As Federal Reserve Board Chairman Alan Greenspan stated, before this committee on April 30, 2003 in response to a question I posed on the FCRA:

> [T]here is just no question that unless we have some major sophisticated system of credit evaluation continuously updated, we will have very great difficulty in maintaining the level of consumer credit currently available because clearly, without the information that comes from various credit bureaus and other sources, lenders would have to impose an additional risk premium because of the uncertainty before they make such loans or may, indeed, choose not to make those loans at all.

Congress enacted the FCRA in 1970, to bring the consumer credit reporting industry under Federal regulation and to create a uniform system of rights governing credit reporting transaction. This mandate has been incredibly successful and allowed for the creation of the sophisticated system we have today. It has greatly expanded consumer access to credit and allowing individual states to enact their own standards would undoubtedly risk its collapse.

Extending these uniform standards has been endorsed by both Treasury Secretary Snow and Chairman Greenspan, who made his support explicit with these remarks before also before our committee, "I've been in favor of national standards here for reasons which are technically required. If you have very significant differences state by state, it would be very hard to maintain as viable a system as we currently have."

Thank you again, Mr. Chairman, for holding this important hearing and I look forward to swift committee action on this issue.

OPENING REMARKS FOR THE HONORABLE RUBEN HINOJOSA
HOUSE FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
"THE IMPORTANCE OF THE NATIONAL CREDIT REPORTING SYSTEM"
TO
CONSUMERS AND THE U.S. ECONOMY
MAY 8, 2003

Chairman Bachus and Ranking Member Sanders,

I want to thank you for holding this much-anticipated and important hearing today to determine the importance of the national credit reporting system. I look forward to the series of hearings this Subcommittee and other Subcommittees will hold to further clarify the issue.

My office has been contacted by numerous individuals and groups about the Fair Credit Reporting Act over the past few months. I personally have heard from industry, consumer groups and several regulators on this issue.

One of the main decisions we, as a Committee, will need to make is whether to extend all seven exceptions to the Fair Credit Reporting Act that preempt state law, or just some of the exceptions. They all expire January 1, 2004.

We may also have to delve into Identity Theft issues, which I understand are separate and distinct from the Fair Credit Reporting Act exceptions. Gramm-Leach-Bliley privacy issues might also be reopened.

I am wondering if this Committee will limit the scope of the hearings and subsequent legislation as much as possible. Some have told me that we need to remain as focused as possible on the extension of the FCRA exceptions if we are to accomplish anything on this important issue this session.

Determining the importance of the national credit reporting system is going to be very difficult.

On the one hand, industry representatives and Chairman Greenspan of the Federal Reserve Board suggest that privacy laws that restrict the availability of credit bureau data could impose significant economic costs. In fact, in response to written questions I submitted, Chairman Greenspan stated, and I quote:

> "Limits on the flow of information among financial market participants, or increased costs resulting from restrictions that differ based on geography, may lead to an increase in the price or a reduction in the availability of credit, as well as a reduction in the optimal sharing of risk and reward. As a result, I would support making permanent the provision currently in the Fair Credit Reporting Act (FCRA) that provides for uniform federal rules

governing various matters covered by the FCRA and would not support allowing different state laws in this area."

This is a very strong endorsement for the continued preemption of state laws pertaining to the credit reporting system. Almost all of the financial services representatives that have contacted me agree with Chairman Greenspan's conclusion.

However, they seem to be split on whether or not to solely preempt the state law or to open up Gramm-Leach-Bliley to address additional privacy issues. Perhaps we are playing a game of tit-for-tat, but I would like the industry to present a united voice on this issue.

I would seek clarification from industry, all of today's witnesses, future witnesses, Committee staff and the regulators on one issue. Section 507 of the Gramm-Leach-Bliley Act appears to authorize states to enact privacy laws that are more stringent than the Gramm-Leach Bliley standard. Section 506(c) of the Gramm-Leach-Bliley Act also seems to clarify that the Gramm-Leach-Bliley Act in no way modifies or supersedes the Fair Credit Reporting Act and that Act's preemptions of state law. I am interested in knowing how all of today's witnesses interpret the interaction of Gramm-Leach-Bliley and the Fair Credit Reporting Act with regard to state laws on affiliate-sharing.

At the same time, I have also heard from consumer groups and constituents who want the Fair Credit Reporting Act preemption of state law to expire. They are concerned about the need to protect social security numbers, fight identity theft, and ban unfair uses of credit scores by insurance companies.

I intend to research these concerns closely prior to making a final decision on whether to vote to extend the seven exceptions to the Fair Credit Reporting Act.

Mr. Chairman, at this point, I would ask permission to insert for the record the Consumer Federation of America's report entitled "Credit Score Accuracy and Implications for Consumers."

While I understand the difference between the extension of the exceptions to the Fair Credit Reporting Act issue and that of Identity Theft, I understand that the two issues might be considered simultaneously.

As a Member of the Democratic Task Force on Identity Theft, I look forward to discussions of that issue, particularly Mrs. Hooley's legislation, which will likely be introduced today.

I hope that today's witnesses will address some of these concerns, Mr. Chairman, and I thank you again for starting the dialogue on this important issue.

Statement of Congresswoman Darlene Hooley

Subcommittee on Financial Institutions and Consumer Credit

Hearing on May 8, 2003

"Importance of the National Credit Reporting System to Consumer's and the U.S. Economy"

Thank you Mr. Chairman and Ranking Member Sanders,

Good morning, it is with great excitement that I sit here today at the first of the hearings on whether or not to reauthorize the seven expiring provisions of FCRA. As I have said to everyone I have met with on this subject, I am convinced that the credit system in place in the United States is the best credit system in the world. The supremacy of this credit system is no doubt a result of the strength of our financial industry, the watchfulness of our consumer groups, and the thoughtfulness and insightfulness of past Congresses. I am very hopeful that we in the 108th Congress follow the example of past Congresses and debate and consider the reauthorization of FCRA with the same amount of thoughtfulness and insightfulness.

While I mentioned that I believe we do have the best credit system in the world, I also see significant room for improvement, both in industry practices and in government regulation. Foremost on my mind is the rising problem of Identity Theft....a problem that is receiving more an more public, and media, attention—as this front page article in the Washington Post illustrates. It describes a couple in the Washington, DC metro area allegedly living the high life, in a $400,000 house with 2 Mercedes and a Lexus, on other people's credit. This allegation, if true, is outrageous...and we in Congress and throughout the government must do whatever we can to stop such fraud and abuse in the future!

As many of you may know, the Federal Trade Commission (FTC) reported that the number of persons filing complaints of identity theft with the agency nearly doubled from 86,000 in 2001 to 162,000 in 2002. A 2003 survey I recently saw found that 92% of Americans think it is important that the government take action on the issue of identity theft. I know many of us think it is inappropriate to govern by polls, but we cannot, and must not, ignore the fact that Americans throughout the country are begging for us to act and help them.

Today, myself and Mr. LaTourette from Ohio are introducing the Identity Theft and Financial Privacy Protection Act, with nearly 40 original cosponsors—many of which are sitting in this room. This bill is just one of many that will be considered by this committee dealing with identity theft, as many thoughtful people such as Mr. Ackerman and Mr. Clay also have great ideas. I encourage everyone to put their heads together and come up with ideas, this is a problem that should not be ignored and demands all of our thoughtfulness and insightfulness.

Assistant Secretary Abernathy, you have made comments publicly stating your support for legislation to help fight identity theft, and each time I read or hear these comments I welcome them, for I feel this MUST be a central part of this debate. Yesterday I sent over a copy of the Hooley-LaTourette ID Theft legislation, I invite you to look it over and provide any comments or suggestions you'd like, and I invite you to work with me, and this entire Committee, towards a common cause of fighting one of the fastest growing crimes in the country.

Thank you to each of the witnesses for giving up your time today to talk about the nation's credit reporting system and the reathorization of FCRA. I look forward to continued debate on the subject...all the while continuing to keep a necessary watchful eye towards helping our fellow Americans fight identity theft.

Thank you Mr. Chairman.

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Statement of Rep. Carolyn B. Maloney (D-NY)
Subcommittee on Financial Institutions and Consumer Credit
Hearing on the Importance of the National Credit Reporting System
to Consumers and the U.S. Economy
May 8, 2003

This morning the Subcommittee begins consideration of the reauthorization of the Fair Credit Reporting Act (FCRA), sections of which expire at the end of the year. This is one of the most significant topics that this Subcommittee will consider, possibly for many years.

The FCRA has a major impact on the lives of all of our constituents. When families sit around the dinner table and make their monthly budgets it is often the cost of credit that is the greatest variable in figuring family expenses. All consumers should know that credit reports affect the cost of mortgages, car loans and credit cards. What consumers may not know is that credit reports reach even deeper into their lives, impacting their employment prospects and their attractiveness as insurance risks.

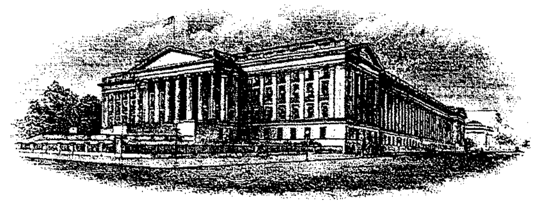
The sweeping impact of the FCRA is further reinforced by an study released yesterday by the Financial Services Roundtable which stated that failing to reauthorize could cost the economy nearly $90 billion in GDP, $20 billion per year in additional incremental interest for consumers and 19,125 fewer single family homes. These are incredibly large numbers, especially in a struggling economy.

While the industry cites the potential significant costs of failing to extend FCRA, I believe the costs of not improving the law while we have a chance are just as important. This Subcommittee must address the tragedy that is identity theft while we have an opportunity. Too often victims of I.D. theft are left to fend for themselves. I have personally talked to constituents who must struggle to repair their credit through a process that can take several years and cost thousands of dollars. Rep. Darlene Hooley has an excellent bill on this issue that I am proud to cosponsor. I hope this bill will be considered as part of FCRA reauthorization. I also believe this debate gives us a significant opportunity to empower consumers to take more control of their credit ratings. We must take additional steps to improve credit report accuracy and increase consumer education efforts. This is especially important for populations that have traditionally been consumers of predatory or high cost lending.

Given the importance of the task before this Subcommittee, I am very pleased that Assistant Secretary Abernathy is here to share the views of the Treasury Department with us the morning. This topic is so important that the position of the Administration will have to be well defined if

Congress is to act in an expeditious manner. In this regard, I am somewhat concerned that with the exception of declaring strong opposition to identity theft the Treasury testimony submitted to the Committee this morning seems to ask more questions than it answers.

The FCRA has incredibly serious consequences for the economy and for individual consumers. I hope we can have a bipartisan agreement that strengthens the credit markets for the benefit of consumers. I yield back the balance of my time.



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

Embargoed Until 10:00 am EDT
May 8, 2003

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Testimony of
Wayne A. Abernathy
Assistant Secretary for Financial Institutions
U.S. Department of the Treasury
before the
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
U.S. House of Representatives

Good morning Chairman Bachus, Ranking Member Sanders, and members of the subcommittee. It is an honor to appear before you today. There could hardly be a more important subject to consider than the information infrastructure of our financial system. So much of the economy, and the welfare of every participant in the economy, is dependent on getting the legal structure of that system right.

In 1996, the Congress undertook an experiment, to determine whether uniform national standards for financial information sharing was the right approach. These uniform standards were embodied in the provisions of the Fair Credit Reporting Act (FCRA). Those provisions are scheduled to sunset at the end of this year. It is therefore appropriate now that Congress evaluate the results of that experiment. We are eager to participate in that evaluation as we develop Administration policy.

To begin with, since the FCRA experience with uniform national standards began, we have witnessed significant increases in the availability of credit to Americans. It is the impact of the legislation on Americans—consumers and businesses—that should guide us in our considerations. We should keep in mind that all Americans have two interests at stake in this matter: an interest in access to credit and other financial services, and an interest in the security of their personal financial information. As Congress reviews these uniform standards, these two interests need to be weighed and taken together and accommodated. I believe that they can be.

In this evaluation, we would suggest considering the following questions:

- Do uniform national standards facilitate or harm the fight against identity theft? Can greater progress against the crime be made with or without uniform national standards for information sharing?
- Do uniform national standards strengthen or undermine the security of personal financial information?
- Do uniform national standards reduce or increase the costs to consumers of financial services?
- Do uniform national standards bring more or fewer people into the mainstream of financial services?
- To what extent do uniform national standards lead to an increase or decrease in the variety of financial services offered to consumers?
- To what extent do uniform national standards help or hinder job creation?
- Is small business development helped or harmed by uniform national standards?
- What would be the impact on unwanted customer solicitations if the uniform standards expired? To what extent are such solicitations facilitated by uniform national standards?
- In short, what costs or benefits to the economy as a whole can be attributed to uniform national standards for information sharing, and what would be the economic impact if they were allowed to expire?

Undoubtedly, there are other questions that should be examined.

At Treasury, one area that we have been particularly concerned about is the role that FCRA uniform national standards play in the fight against identity theft. The importance of this concern can be understood by a brief review of the nature of the crime.

Identity theft is one of the fastest growing crimes in America. By some estimates, there will be as many as one million new victims this year, with many times that number already in the ranks of sufferers.

In a recent national survey of homeowners, 12% reported having been casualties of identity theft, and 22% reported knowing family, friends, or acquaintances who have been. It is hard to think of another crime that has touched such a large portion of Americans. In that same survey, 90% said that they were concerned that they might be a target of identity theft. A separate survey recently found that Americans are more concerned about becoming a victim of identity theft than they are of losing their job. No wonder that 83% believe that the government should take steps to fight the crime.

Many suffer from the unauthorized use of their own legitimate credit card. This is one of the milder versions of the crime, and today perhaps the most common. Fortunately, it is also an aspect where great progress has been achieved in fighting it. As long as the consumer is diligent and promptly reports lost or stolen cards or unauthorized charges, the direct liability to the card holder is zero. The Truth in Lending Act sets the maximum loss at $50, but credit card companies have found that there are great benefits in consumer confidence from eliminating all liability for the innocent victim. The loss still occurs, though, and it adds up to billions each year, ultimately born by all card users in higher prices and higher interest rates.

Credit card companies also have elaborate and well-designed information-sharing systems in place, neuronetworks, that monitor customers' accounts and quickly notify them of charges that are out of the ordinary, such as purchases outside the customers' normal buying patterns or far from home. This is an important deterrent to this type of identity theft. Other financial sectors are working on deterrents appropriate for their business. Much more needs to be done.

The crime occurs in great variety. As I speak, somewhere, someone is using someone else's good name to engage in fraud, to steal from a furniture store, rob a bank account, engage in stock swindles, write bad checks, run up huge phone bills, escape gambling debts, shield illegal drug deals, create false résumés, impersonate doctors or other professionals, destroy reputations.

Do not look for patriotism among identity thieves. When our soldiers, sailors, and airmen move to the front lines to engage the enemy, the identity thieves are ready to take advantage of their absence to steal their identities to commit fraud. I would guess that the soldier in the Third Infantry Division in Baghdad is not giving much thought to his bank account, or worrying about his credit cards, certainly not looking at his financial statements. But the fraudster is paying attention, for he knows that the fraud could go undetected for a long time, unless friends and family are vigilant, on the watch here at home over the financial affairs of the service man and woman overseas.

Not even the dead are immune from identity theft. Necrolarceny is one of the more repulsive, but not uncommon, faces of the crime. Thieves scan the obituaries and gather the information provided there to impersonate the deceased. From the obituary, the thief harvests a wealth of knowledge: the full name, a maiden name, age, names of family members, possibly education and charitable activities—all types of information that the thief can draw from to impersonate the deceased and, possibly, other family members. And closing down financial accounts is not usually high on the To Do List of bereaved family members. Yet there may be a tragic surprise awaiting when a will reaches probate and the family members learn how financially active their mother was in the days and weeks following her death.

No one sitting in this hearing room is immune from identity theft. Undoubtedly, there are many here who have been victimized or know someone who has. There may be some here who are being victimized right now and won't know of it for several more weeks or months.

Perhaps someone is dumpster diving, going through your trash to get important bits of information about you or your accounts. Perhaps someone will call, impersonating a government employee, asking to "verify" some of your personal data in order to continue to send you your Social Security check or veterans benefits. Maybe you will be snared by a supposedly "free" service on the Internet, that only needs your name, address, date of birth, and so on, in order to provide you with access to the free service.

Arguably, the most virulent form of identity theft occurs where the crook takes your good name and uses it to open new accounts that you know nothing of, with the statements going to places you have never been, so that weeks and months pass without your knowledge of the fraud. The crook may even keep up minimum payments for a time until he can max out on the credit limits. Then he disappears, the payments stop and the creditors come looking. But they don't find the crook. They don't look for the crook. They look for you. And you discover the fraud when you can't pay for your dinner because your charge will not clear. Your home equity loan is turned down because there already is a lien on your house. You lose your job, because, though your boss is very sorry and thought you were an exemplary employee, he can't have someone in such a sensitive job who has such a poor credit history.

And then you will see perhaps the most painful face of all the many faces associated with the crime of identity theft, the face of the victim. Where do you go? How do you begin to clear your name? How do you convince creditors all around the country that you never made those transactions, that there must be some mistake? Do you turn to your local police department? They might fill out a police report, but victims report that many do not. What can the local police do about it anyway? The crime took place in Bigtown, not in your home town. Will the Bigtown police take up the case? Maybe, but you live in Virginia. Who will handle a case for a victim living in Charlottesville, for fraudulent transactions made in Miami, Denver, and San Francisco, with money borrowed over the Internet from a bank headquartered in Philadelphia? Crooks have long sought to exploit State lines to avoid punishment.

The General Accounting Office reports that it can take victims as many as 175 man hours to clear their name and their records. That would be the equivalent of more than one full month of 8-hour days, five-day work weeks of full-time work. Of course, that is spread out over time, over months and sometimes years, with thousands of dollars of expenses.

What role have the uniform national standards in the FCRA played in the fight against identity theft? What role might they play? Are they more likely to cause the crime, or can they be enlisted in the fight against it?

The answer lies in information. Information is what the FCRA is all about. So, first of all, we need to consider the role of information in identity theft. Certainly the crook uses information. He uses information to craft a mask, as much in the likeness of his victim as he can make it. What steps can we take, if any, to deny the thief the information tools he needs to make his mask? In answering that question, what tools can we find to fight the crime?

But does it end there? In what way might we be able to put information to work to fight the crime? If the merchant or banker knows more about his customer than the thief does, can we unmask the crook and prevent a loss from occurring? If information about the thief can cross state lines faster than he can, might we enable the sheriff to meet the thief at his next stop?

And what role does information play in restoring the records of victims? Are uniform standards contributing to placing bad information on consumer records? Can they be harnessed in the effort to eradicate the false information?

As we consider the uniform standards for information sharing under the FCRA, we anticipate working with you to consider how this review can help in the crucial fight against identity theft.

So, as I said in the beginning, whether considered from the impact on each family in America, or on the economy as a whole, there could hardly be a more important inquiry than the one you begin today. We are eager to join with you in that review. It is vitally important that we get the answer right.

Thank you. I will now be pleased to answer your questions.

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Testimony

Of

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Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
United States House of Representatives

108th Congress, 1st Session

Hearing on "The Importance of the National Credit Reporting System to Consumers and the U.S. Economy"

May 8, 2003

Mr. Chairman, Ranking Member and Members of the Subcommittee,

I commend you for convening this hearing on the national credit reporting system and would like to thank you for the honor and opportunity to testify. My name is Joel R. Reidenberg. I am a Professor of Law at Fordham University School of Law where I teach courses in information privacy, international trade and comparative law. As a law professor, I have written and lectured extensively on the regulation of fair information practices in the private sector. My bibliography includes scholarly articles and two co-authored books on data privacy.[1] Of specific relevance to today's hearing, I have studied and written about the Fair Credit Reporting Act ("FCRA") as well as assisted the Federal Trade Commission in its successful litigation against Trans Union's illegal disclosure of credit report information for marketing purposes.[2] I am a former chair of the Association of American Law School's Section on Defamation and Privacy and have also served as an expert advisor on data privacy issues to state and local governments, to the Office of Technology Assessment in the 103rd and 104th U.S. Congresses and, at the international level, to the European Commission and foreign data protection agencies. I appear today as an academic expert on data privacy law and policy and do not represent any organization or institution with which I am or have been affiliated.

My testimony will focus on three points: (1) the US credit reporting system needs strong privacy protections to preserve a robust national information economy; (2) the substantial weaknesses in the FCRA introduced in 1996 with the provisions on affiliate sharing and unsolicited offers pose a threat to a safe and sound credit reporting system; (3) Congress must continue to assure the integrity of the credit reporting system through stronger fair information practice standards.

<u>Strong Privacy Protections are Essential for the Credit Reporting System</u>

The FCRA was enacted in 1970 as a response to significant abuses in the nascent credit reporting industry. Decisions affecting citizens' lives were being in secret with bad data. Congress heard extensive testimony during the late 1960s on the unfair and abusive information practices that voluntary industry guidelines failed to prevent. These included the release of credit information to non-credit grantors, the dissemination of inaccurate credit information, the inability of consumers to gain access to their credit reports, and the difficulty of consumers to obtain correction of erroneous information.[3]

In enacting the original FCRA, Congress wanted to assure the efficiency and integrity of the U.S. banking system. The statute became the cornerstone of US privacy law. Congress recognized that fair information practices were essential for vibrant credit markets and expressly sought "to prevent an undue invasion of the individual's right of privacy in the collection and dissemination of credit information."[4] At the time, the FCRA was an extraordinary and unique statute precisely because the law set a new standard for strong privacy protection. The FCRA established a then-novel system of opt-in permission for the dissemination of credit report information. The statute defined a specific set of permissible purposes for which the disclosure of credit report information was authorized. These purposes related directly to the reasons for which data was collected and are generally limited to the extension of credit, insurance or employment. Any other disclosure of credit report information requires the written consent of the consumer. Among other important innovations for fairness, the law created transparency in the industry by granting a consumer the right of access to credit report information and by requiring the industry to identify the recipients of credit reports. The law further provided rights for consumers to dispute inaccurate information contained in their credit reports.

The fairness rules and opt-in approach contained in the original FCRA enabled the credit reporting industry to progress from its fragmented, chaotic and abusive period in the late 1960s to a successful, respected component of the U.S. information-based economy. The FCRA obligations, in effect, created today's thriving national infrastructure of credit reporting.

From the start, however, Congress recognized that the credit reporting industry would be likely to evolve significantly and that even greater privacy and fairness could benefit the banking industry. As a result, Congress permitted the states to enact stronger privacy protections for credit reporting since stronger state statutes promoted the main goals of the original FCRA. In fact, most subsequent fair information practice legislation for the private sector in the United States expressly waived, in whole or in part, federal pre-emption such as the Financial Services Modernization Act, the Health Insurance Portability and Accountability Act, the Cable Communications Policy Act, and the Video Privacy Protection Act. By 1996, when Congress adopted a number of significant amendments to the FCRA, the credit reporting industry had grown dramatically and, indeed, operated nation-wide in a seamless fashion notwithstanding diversity at the state level.

Among the 1996 FCRA amendments, Congress included a partial pre-emption clause that only precludes states for another eight months from implementing certain types of stronger credit reporting provisions. The 1996 amendments specifically exempted the stronger California, Massachusetts and Vermont statutes from pre-emption.[5] To my knowledge, no industry group has examined the effects of these three stronger state statutes on either the credit markets in those states or on the nation-wide industry. This is not surprising. A rudimentary look at federal statistics suggests that credit decisions in these states benefit both lenders and consumers. Consumer bankruptcy filings per household, a basic sign of bad credit decisions, are markedly better for these three states with more protective credit reporting statutes. Vermont ranks 50th with the lowest rate of consumer bankruptcies in the nation, Massachusetts is 49th and California comes in below the median at 27th.[6] Mr. Chairman, your state, Alabama, without a stronger law, has a much higher rate of consumer bankruptcy and is ranked as the 5th highest in the nation.[7] Similarly, federal statistics on interest rates seem to indicate that states with stronger credit reporting laws have lower rates. The most current annual federal mortgage loan data indicates that the effective rate on a conventional mortgage for 2002 was 6.25% in California, 6.43% in Massachusetts and 6.59% in Vermont.[8] All were below the national median and California had the lowest rate in the nation. Your state, Mr. Chairman, had an effective rate of 6.65% meaning that your constituents appear to be paying higher mortgage rates than those in more privacy protective states. While these statistics leave out important elements for a thorough assessment of the impact of stronger state laws such as a correlation with state unemployment data for bankruptcy filings and non-interest transaction costs for home mortgage loans, the data does show that the horror stories circulating about the pre-emption provisions make good theater, but reflect poor research.[9]

The bottom line is that strong privacy protections are essential for public confidence in the integrity of financial services in the United States. For information used to make financial decisions about consumers, citizens believe that fairness requires opt-in permission. In 2001, citizens in North Dakota had the first and only opportunity in the nation to take a real position at the polls on the dissemination of their personal financial information. The North Dakota state legislature had just watered down financial privacy from an opt-in rule on data sharing to an opt-out rule. The citizens of North Dakota revolted. By an overwhelming 72% majority, the voters of North Dakota approved a referendum restoring the old opt-in rule and rebuking the legislature's weakening of privacy standards. Strong privacy clearly matters to voters and to the health of our financial and credit system.

<u>Substantial Weaknesses and Threats to a Safe and Sound Credit Reporting System</u>

The basic tenent of fair information practices is that information collected for one purpose should not be used for different purposes without the individual's consent. Deviations from this key standard threaten a safe and sound credit reporting system in the United States. The circulation of credit report information outside the core permissible purposes increases the risk of identity theft, decreases the accuracy and reliability of credit information and decreases the public's trust in the credit industry.

Unfortunately, the 1996 Amendments deviated from the FCRA's historical commitment to opt-in with respect to two critical areas: affiliate sharing and pre-screening. The amendment to the definition of a "consumer report" allowed organizations to escape the fair information practice obligations of the FCRA for information that would otherwise be covered if such data were to be disseminated to affiliates provided that consumers have a one-time chance to opt-out. The amendments also authorized a narrowly drawn exception from the written consent requirements so that the FCRA now permits pre-screening of credit report information to make unsolicited, firm offers of credit or insurance. Congress accepted this deviation from the core purposes only with additional safeguards including record-keeping obligations, transparency obligations and easy opt-out procedures. Congress thought it would still protect what Senator Proxmire sought to preclude when he introduced the original FCRA: "the furnishing of information to Government agencies or to market research firms or to other business firms who are simply on fishing expeditions."[10]

Industry practices, however, try to exploit and circumvent the careful protections of the FCRA. For example, under the guise of pre-screening offers of credit, a major national wireless phone company shamelessly rummages through consumer credit reports to find marketing prospects for phone service and free phones. Other major national companies sell detailed personal financial information to government agencies and private sector organizations for the purpose of making decisions that will affect those individuals without conforming to the FCRA. These practices resemble the very abuses that Congress sought to prevent through the FCRA.

The creeping data leakage of credit information for secondary purposes of affiliate sharing, unsolicited offers and non-credit decision making undermines confidentiality and security of personal information. In terms of affiliate sharing, the successful liberalization of the financial services sector since the enactment of the FCRA means that the definitional exemption has far reaching implications today. Large organizations engaged in exactly the same behavior that Americans find troubling-- the dissemination of confidential personal information for a wide range of activities unrelated to the purpose of collection-- escape the obligations of consumer reporting agencies and the opt-in rule. With respect to unsolicited offers of credit and insurance, the deviation from the core permissible purposes has proven unjustified. A lobbying paper sponsored by an industry group, the Privacy Leadership Initiative, admits that the average response rate to credit card offers in 2000 was only 0.6 percent.[11] I am not aware of any publicly disclosed information showing substantially higher response rates for pre-screened lists. Consumers simply are not interested in these offers. Yet, this type of secondary use of credit information creates an important leakage of data from confidential and secure credit reporting.

Some have argued that strong credit reporting rules overseas substantially hinder the "miracle of instant credit" and result in much higher interest rates. These arguments have no apparent basis in demonstrated fact or analysis. No other country to my knowledge has a comparable statute governing only credit report information. Comprehensive data privacy laws applicable to most processing of personal information do exist outside the United States such as those in Canada, in the United Kingdom and throughout Europe under European Directive 95/46/EC. These laws typically apply to credit reporting and are generally more protective of consumers than the FCRA. However, foreign consumer credit markets are structured by banking law, bankruptcy law, real estate law, and consumer protection laws that often deviate significantly from the US legal system. The attribution of differences in credit markets to general data privacy laws without examination of the direct regulatory constraints on credit relationships and loan security is specious and a misrepresentation of foreign privacy law.

Other countries with comprehensive data protection statutes such as Canada demonstrate that robust credit information services can co-exist with strong, comprehensive data privacy laws. In fact, one major US credit reporting agency operating in Canada offers a typical credit report for Canadians that contains information strikingly similar to the typical report for Americans. In the United Kingdom where a comprehensive data privacy law also applies, major credit card companies also offer instant approvals for platinum cards.

In short, the FCRA needs to restore its original ground-breaking protections for consumer privacy to ensure public confidence and the integrity of the credit report information.

Recommendations for Future Action

1. Legislate higher standards of privacy to assure the integrity of the credit reporting system and public trust by specifically returning pre-screened offers to the opt-in approach of the original FCRA or by allowing the states to establish higher standards.

2. Expand the definition of "consumer report" in the FCRA to cover affiliate sharing or allow the states to modify the definition.

3. Extend the protections of the FCRA to the dissemination of personal information collected for the purpose of making any type of financial decision about the consumer so that similar activities affecting consumers do not escape fair information practice standards

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[1] Paul M. Schwartz & Joel R. Reidenberg, DATA PRIVACY LAW (Michie: 1996); Joel R. Reidenberg and Paul M. Schwartz, ONLINE SERVICES AND DATA PROTECTION LAW: REGULATORY RESPONSES (Eur-OP: 1998); Joel R. Reidenberg, *Privacy Wrongs in Search of Remedies,* 54 HASTINGS L. J. -- (forthcoming); Lorrie Cranor & Joel R. Reidenberg, *Can user agents accurately represent privacy notices?,* TPRC 30th Research Conference Paper # 65 (2002) available at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=328860> ; Joel R. Reidenberg, *E-commerce and Trans-Atlantic Privacy* , 38 HOUSTON L. REV. 717 (2001); Joel R. Reidenberg, *Resolving Conflicting International Data Privacy Rules in Cyberspace* , 52 STANFORD L. REV. 1315 (2000); Joel R. Reidenberg , *Restoring Americans' Privacy in Electronic Commerce* , 14 BERKELEY TECH. L. J. 771 (1999): Joel R. Reidenberg, *Setting Standards for Fair Information Practice in the U.S. Private Sector*, 80 IOWA L. REV. 497 (1995); Joel R. Reidenberg & Francoise Gamet-Pol, *The Fundamental Role of Privacy and Confidence in Networks*, 30 WAKE FOREST L. REV. 105 (1995); Joel R. Reidenberg, *Rules of the Road on Global Electronic Highways: Merging the Trade and Technical Paradigms*, 6 HARVARD J. LAW & TECH. 287 (1993); Joel R. Reidenberg, *The Privacy Obstacle Course: Hurdling Barriers to Transnational Financial Services*, 60 FORDHAM L. REV. S137 (1992); Joel R. Reidenberg, *Privacy in the Information Economy-- A Fortress or Frontier for Individual Rights?,* 44 FED. COMM. L. J. 195 (1992). Copies of most of my articles may currently be found on my web site at: <http://reidenberg.home.sprynet.com>

[2] In re: Trans Union, FTC Docket No. 9255, *aff'd* Trans Union Corp. v. FTC, 245 F.3d 809, 811 (D.C. Cir., 2001) *cert denied,* 122 S. Ct. 2386 (2002).

[3] See e.g. S. Rep. 91-517, 91st Cong., 1st Sess. (1969); Hearings on Commercial Credit Bureaus before the House Special Subcommittee on Invasion of Privacy of the Committee on Government Operations, 90th Cong., 2nd Sess., March 12-14, 1968; Hearings on Fair Credit Reporting S. 823 before the Senate Subcommittee on Financial Institutions of the Committee on Banking and Currency, 91st Cong., 1st Sess. (May 19-23, 1969)

[4] S. Rep. 91-517, 91st Cong., 1st Sess. 1 (1969)
[5] 15 U.S.C. 1681t(b)(1)(F)
[6] American Bankruptcy Institute, US Bankruptcy Filing Statistics: Households per filing, Rank (2003) (using "statistics based on data from the Administrative Office of the U.S. Courts (2002 bankruptcies) and the U.S. Bureau of the Census.") available at http://www.abiworld.org/stats/householdrank.pdf
[7] Id.
[8] Federal Housing Finance Board, Periodic Summary Tables: Table IX—Terms on Conventional Home Mortgages 2002 available at http://www.fhfb.gov/MIRS/mirstbl9.htm
[9] See also, Robert Gellman, No Fair Fight over FCRA Provisions, DM News, May 5, 2003, pp. 12-13.
[10] Cong. Rec. Senate, Jan. 31, 1969 (statement of Sen. Proxmire) reprinted in Hearings on Fair Credit Reporting S. 823 before the Senate Subcommittee on Financial Institutions of the Committee on Banking and Currency, 91st Cong., 1st Sess., at 436 (May 19-23, 1969)
[11] Michael E. Staten & Fred H. Cate, Paper prepared for the Privacy Leadership Initiative "The Adverse Impact of Opt-In Privacy Rules on Consumers: A Case Study of Retail Credit," at 25 (April 2002).

National Retail Federation
The Voice of Retail Worldwide

Testimony of Dean E. Sheaffer
Senior Vice President of Credit and CRM
Boscov's Department Stores, Inc.

on behalf of the

National Retail Federation

before the

House Financial Services Committee
Subcommittee on Financial Institutions
May 8, 2003

PREPARED STATEMENT OF DEAN E. SHEAFFER,

SENIOR VICE PRESIDENT OF CREDIT AND CRM,
BOSCOV'S DEPARTMENT STORES, INC.,
READING, PA
REPRESENTING THE NATIONAL RETAIL FEDERATION

Good Morning. My name is Dean Sheaffer. I am Senior Vice President of Credit and Customer Relationship Management for Boscov's Department Stores and Chairman of the Pennsylvania Retailers' Association. I am testifying today on behalf of the National Retail Federation. I would like to thank Chairman Bachus and Ranking Member Sanders for providing me with the opportunity to testify before the Subcommittee on Financial Institutions. I would also like to thank all the members from the Pennsylvania delegation who sit on this subcommittee for welcoming me here today.

Boscov's is primarily a Mid-Atlantic department store chain. In addition to stores in Maryland and New Jersey, we have 3 stores in Delaware, 3 stores in New York, and more than two dozen stores in our home state of Pennsylvania. Boscov's employs over 10,000 people. As the third largest industry in my home state of Pennsylvania, retailers employ over 1.25 million people earning more than $25 billion in wages.

The National Retail Federation (NRF) is the world's largest retail trade association with membership that comprises all retail formats and channels of distribution including department, specialty, discount, catalogue, Internet and independent stores. NRF members represent an industry that encompasses more than 1.4 million U.S. retail establishments, employs more than 20 million people—about 1 in 5 American workers—and registered 2002 sales of $3.6 trillion.

In 1911, Solomon Boscov arrived in Reading, Pennsylvania, purchased $8 worth of merchandise, rolled his wares into a pack and set off into the surrounding countryside. He sold wares, exchanged merchandise for meals, did chores in exchange for lodging and made hundreds of friends. Within the year he saved enough money to buy a horse and wagon and increase his inventory. Solomon established the first Boscov's store at 9th and Pike Streets in Reading, Pennsylvania and went about building his family of stores.

In those days, retailers granted store credit by word of mouth and the customer's good reputation. In fact, Solomon's son and our Chairman, Albert Boscov, has reminded me that when times were bad Solomon would allow parents to buy their children's school shoes on the "I know you will pay when you can" credit plan. This sense of common trust and the idea of making friends with our customers is still the core of building our business and improving the communities that we serve.

As towns and cities grew, retailers began using their local merchant's associations as a trusted repository for information about the customers with whom they dealt. In order to access the files, the merchant had to be willing to place his own information into the system. There was a strong incentive to be accurate and careful with what you put in because you expected the same care from the other merchants with whom you were sharing. Trust and integrity were important. Eventually the merchant's associations were merged, or sold, and became part of the credit reporting system we have today.

Today, Boscov's has 1.1 million active credit card accounts. During the peak holiday season, about 600,000 of these customers use their Boscov's card and receive credit card statements from us. Activity on all accounts, not just past due accounts, is reported monthly to the three major credit bureaus. As many of you know, consumers often use retail credit as their gateway into the larger credit market. It very common for a Boscov's card to be the first credit card in a customer's wallet. By building a good credit relationship with us, they help build a good credit file with the credit bureaus. This, in turn, makes them eligible for other credit products such as a car loan or even a first mortgage.

I am here today to express strong support, on behalf of both Boscov's and the retail industry as a whole, for the permanent reauthorization of the seven areas of state law preemption contained in Section 624 of the Fair Credit Reporting Act or FCRA. These preemptions govern: ***Reinvestigation Timeframes*** (the time by which a credit bureau must take any action in any procedure related to the disputed accuracy of information in a consumer's file); ***Adverse Action Responsibilities*** (the duties entities have when taking "adverse action" against a consumer on the basis of information contained in a credit report or on information obtained from third parties other than credit bureaus); ***Prescreening*** (the process of selecting consumers for "preapproved" offers, and the duties imposed on those entities engaging in prescreening); ***Information Contained in Credit Reports*** (including obsolete information and information regarding delinquencies); ***Furnisher Responsibilities*** (the obligations and potential legal liability imposed on those entities that report raw data to credit bureaus); ***Consumer Disclosures*** (the form and content of certain disclosures which must be provided by a credit bureau to a consumer); and ***Affiliate Sharing*** (the exchange of information among affiliated entities, regardless of whether such information is a credit report or credit related).

As I noted before, the history and success of retail is inextricably intertwined with credit granting in this country. Today, over eighty percent (80%) of purchases made at Boscov's stores are on some type of credit card; be it Visa, MasterCard, Discover or the Boscov's card. In 2002, consumer spending represented two-thirds of the Gross Domestic Product. If you do some simple calculations, you realize that most of the transactions in our economy don't happen in cash – they happen on credit. Mr. Chairman, as you know, it is consumer spending that has served as the ballast in an otherwise unstable economic environment. Consumers are taking advantage of quick, low-cost credit at record rates, from first-time home mortgages and mortgage refinancings, to car loans and other consumer credit transactions. The system that makes all these transactions efficient and even possible is our current national credit reporting system.

In fact, the uniform standards adopted in 1996 have coalesced nicely with emerging computer technology to create the most fair and efficient credit reporting and credit granting system in the history of our country. Sophisticated models have allowed creditors to more accurately assess risk and have allowed for the introduction of innovative products and lower APRs. Additionally, uniform computer applications such as E-oscar and ADVS allow furnishers such as Boscov's to correct reported information and clear up disputes quickly and much more efficiently.

I would like to highlight some of the areas of the law that are most important for retailers, but, again, please bear in mind that retailers strongly support all seven of the current preemptions.

Furnisher Responsibility

Uniform standards on furnisher obligations are critical to the integrity and overall success of the current voluntary reporting system. In an age where trial lawyers loom at every turn, the limits on furnisher liability help keep credit granters in the reporting system. Inconsistent or heightened liability standards and the creation of new private rights of action would ultimately discourage lenders from supplying information – particularly negative information – out of fear of being sued. Like the system established by the merchant's associations of old, credit reports are only as good as the information going in. If a potential creditor does not have a complete view of the consumer's information because other creditors are withholding information the risk-assessment may not be adequate. This perceived increased risk would have to be factored into the loan, driving up the cost of credit and diminishing credit availability in those communities.

Reinvestigation Time Frames

Some of the largest retailers report on over seventy-five million customers per month to the three national credit bureaus. Remarkably, the reported error rate is well under one half of one percent (.05). Oftentimes, these errors are simply mismatches of information to credit bureau files and never impact a consumer's report. Examples of these types of mismatches are minor variances in a customer' name, address or date of birth. Further, significant errors that inadvertently make it on to reports are corrected quickly at the consumer's request, often in much less time than the thirty days required under the FCRA. The usual time to handle a dispute at Boscov's is about fourteen days; however the full thirty days may be needed to resolve more complex disputes.

Again, the national uniformity established in 1996 helps make this efficient system possible. If states were allowed to act independently to shorten these periods to twenty, fifteen or even ten days, consumers would necessarily be treated differently by furnishers based simply on their state of residence. Disputes in a thirty-day state would always be bumped back the minute a complaint came in from a consumer in a ten-day state. Imagine the frustration for customers as well as the complication for merchants who operate in multiple states. As I previously noted, Boscov's operates in five Mid-Atlantic States. For us, this could mean having five separate dispute resolution procedures in place. For the largest retailers it could mean having fifty different procedures in place.

Prescreening

Another important preemption under the FCRA is that for prescreening. Retailers like Boscov's use prescreening to grow our customer base. This isn't just important to our credit card business. We use this same customer base as the best predictor of where to open a new store. With a typical store size of 200,000 square feet, we operate almost exclusively as an anchor store in regional Malls. For us, it takes as many as ten to twenty thousand known customers to venture into a new location. Boscov's is still growing. We open an average of two to three stores per year. Last month, we opened our newest store in Westminster, Maryland and in the fall we will open another in Frederick. Over the past few years we have opened one or more stores in every state in which we do business. If any Mid-Atlantic state were to act to prohibit prescreening, it would undoubtedly slow down Boscov's stores entry in to new markets in that state.

Affiliate Sharing

As a department store retailer, I think it would help committee members understand our business much better if I take a moment to explain the structure of our stores. A Boscov's department store is considered to be a reliable place for one-stop shopping by our customers, but, in fact, it is really a web of affiliated companies and third-party licensees providing exceptional services under the Boscov's company name. For example, the Clinique and Lancome counters are operated by Clinique and Lancome under a third-party contractual agreement with our stores. This is also true for the Ritz Camera store. Additionally, a licensee company runs many of our fine jewelry counters, offering knowledge that brings quality merchandise at the best prices to our customers.

Boscov's also runs several retail affiliates including Boscov's Tavelcenter, our hearing aid center, and the warranty department that services the electronics and appliances we sell in our stores. Additionally, Boscov's Receivable Finance Corporation and Boscov's Credit Card Master Trust, both Boscov's affiliates, serve as the basis for our credit card business. The contract for servicing those accounts is, in turn, held by Boscov's Department stores.

This complex business structure is necessary for many legal and accounting reasons, however the structure is completely transparent to our customers. What they get is the great customer service that has kept them shopping with us for years. In fact, our credit card center is also a call center where customers can work out issues such as merchandise delivery problems, place phone orders, seek assistance with Internet orders, and ask a whole host of questions about our products, services and promotions. They can even opt-out of our mailing lists for catalogs, promotions and store coupons if they so choose. This is all made possible by information sharing in the retail environment. Through information sharing we can not only market more specifically to our customers and meet their needs, but we can also do other things such as underwrite more credit and combat identity theft in our stores.

Mr. Chairman, a lot of people ask what affiliate sharing has to do with the granting of credit. The answer is: a lot. Retailers use the data and transaction histories that they collect from their stores and affiliates to create internal credit scores and models that help determine a consumer's eligibility for credit. This information supplements credit reports and FICO scores to paint the most accurate picture possible of a customer. In fact, retailers most often use this type of information to grant credit to people on the margins and those who are just entering the credit market.

For instance, if someone comes in to a retail store needing a new refrigerator or washer/dryer, they often apply for "instant" credit to complete the purchase. When the retailer pulls their credit report they may see a lower-than average FICO score or information indicating a bankruptcy five years ago. These are often reasons to deny credit, but, by using their own internal models that predict the credit habits of similarly-situated customers, the retailer may be able to draw the conclusion that the current customer is not, in fact, a credit risk. Again, this type of information sharing helps retailers determine risk and underwrite credit, allowing people at the margins in lower to middle income households with mediocre FICO scores obtain credit when they most need it.

Retailers also use information to fight identity theft. As you know, identity theft is one of the fastest growing and most troublesome crimes in the United States. At Boscov's we have implemented a number of safeguards to help protect our business and our customers. As you will see, many of these procedures rely directly on the sharing of information.

When a customer applies for the Boscov's charge card in one of our stores, they must present a current, valid, state or federally issued picture I.D. (such as a driver's license or passport). When we pull the customer's credit bureau report, we determine if the name, address, social security number and various other characteristics given by the customer match both the information on the I.D. presented and the information contained in the credit bureau report. In addition, our system is built to recognize various "fraud flags" in credit reports and also to request human review for any credit bureau report that contains a written "consumer statement." Questionable applications are referred for further processing to ensure that the applicant is in fact who they purport to be.

ID theft prevention does not stop when the credit application is approved. Many retailers like Boscov's have models or "neural networks" that identify unusual purchasing behavior. For example, if we see an account that is normally only used for small purchases suddenly being used to make large, high risk purchases on-line using a different shipping address, our systems will flag the transaction as "highly suspicious" and it will be referred to a special unit for investigation. We also have a number of customers who either have in the past been victims of identity theft or who believe they are likely to be victims. For these customers, we program our register system to immediately refer the sale to our credit center. Here we will verify the customer's identity via a valid ID or password.

Sadly, ID theft continues to grow and affect both of its victims: the merchant and the customer. Our losses related to ID theft continue to grow year after year despite our best efforts. We are constantly challenged to find new patterns in our many data sources that will help us identify fraudulent transactions without inconveniencing our legitimate customers. Without the ability to search all data sources available to us, ID theft would grow at an even greater rate. The ability to share, aggregate and search affiliate and third party data sources is paramount in the effort to protect Boscov's and our valued Boscov's customers.

Information Contained in Credit Reports

Today, creditors rely on the fact that when they pull a copy an individual's credit report, no matter what that individual's state of residency may be, they are always getting the same reliable information. If the FCRA preemptions are not extended each state will be able to establish its own content requirements for credit reports. For example, a state may chose to lengthen the time in which consumers can pay overdue bills without those delinquencies appearing on their credit reports. A state could further shorten the time during which negative information can remain in a credit report.

As I mentioned before, Boscov's operates in five states. A state-mandated ninety-day delay for reporting a delinquency in Maryland, for example, would keep Boscov's from being alerted to a recent credit problem. Just think of it: we would have no way of knowing if an individual has paid any of their bills for three months. Our Maryland customers would then have to be treated differently when applying for credit than customers in New York or Pennsylvania. In addition, such a change in state law could encourage some individuals to "work the system" by routinely paying overdue bills just in time to avoid the ninety-day "delinquency reporting" deadline. The result would be a significantly less reliable credit granting system.

A state-mandated two- or three-year information history limit on applicants' credit reports would also be problematic. Today, all positive and negative information stays on a consumer's credit report for seven years and bankruptcies appear for ten years. With less information to work from, it would be more difficult for credit grantors to identify both high-risk applicants and increasing risk among existing accountholders. Mr. Chairman, an information vacuum can be highly detrimental to a credit decision – sometimes even more so than relatively old negative information.

In closing, I would again like to emphasize the retail industry's strong support for the permanent reauthorization of the seven areas of preemption contained in section 624 of the Fair Credit Reporting Act. Without the extension of the uniform national standards, retailers and the customers we serve may be subject to a confusing patchwork of new state laws, rules and regulations. The current uniform national standards allow retailers and lending institutions to get a complete and accurate picture of a person's credit history. Without uniform national standards, it will be harder to judge with any confidence the credit worthiness of each individual customer, slowing the credit approval process and leading to higher lending costs.

Mr. Chairman, members of the Committee, consumers have come to expect instant access to credit when purchasing everything from an automobile to consumer goods such as furniture, appliances and apparel. In the final analysis, we in the retail industry have a real concern that a more fragmented approval processes for credit would negatively impact consumers and, as a consequence, retail sales, ultimately costing jobs and hurting the economy as a whole.

Thank you again for the opportunity to testify here today. I look forward to working with all the members of this Committee to permanently reauthorize the FCRA preemptions before they expire on December 31of this year.

United States House of Representatives

Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

Hearing on "The Importance of the National Credit Reporting System to Consumers and the U.S. Economy"

May 8, 2003

Testimony:

The Impact of National Credit Reporting Under the Fair Credit Reporting Act

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United States House of Representatives
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Testimony: The Impact of National Credit Reporting under the FCRA

Testimony of Michael E. Staten
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Introduction

Good morning Mr. Chairman and members of the Committee. My name is Michael Staten. I am Professor of Management and Director of the Credit Research Center at the McDonough School of Business at Georgetown University. The Center is a non-partisan, academic research center devoted to studying the economics of consumer and mortgage credit markets. Over its 29-year history the Credit Research Center has generated over 100 research studies and papers, most of which examine the impact of public policy on credit markets. Throughout its history, the Center's research program has been supported by a mix of grants from the public sector (e.g., National Science Foundation, Federal Trade Commission) and unrestricted private sector grants from foundations and corporations made to its host University on behalf of the Center. I have served as the Center's director since 1990.

I'm pleased to be able to share with you this morning the results of two specific reports that I have recently co-authored that assess the impact of the Fair Credit Reporting Act (FCRA). I will begin by stating the general conclusion of both reports. The available evidence – economic and otherwise – suggests that the voluntary national credit reporting system that has evolved under the FCRA has generated extraordinary benefits for individual consumers and the nation as a whole, and has helped to make the United States the world leader in the development of competitive consumer and mortgage credit markets. Proposals to depart from a national reporting system by allowing states to intervene in setting new credit reporting rules run the risk of upsetting the carefully balanced interests under the FCRA, and diluting the benefits that flow from the existing system.

I. The FCRA, Federal Preemption and the National Credit Reporting System

Credit reporting in the United States evolved during the twentieth century as a market-driven response to creditors' need to determine the likelihood that borrowers would repay loans. The credit reporting industry was largely unregulated until passage of the Fair Credit Reporting Act in 1970.[1] In the FCRA Congress struck a balance that was intended to encourage more voluntary reporting of consumer borrowing and payment histories, while promoting greater accuracy in reporting and addressing consumers' privacy concerns regarding uses of credit report information.

In 1996 Congress amended the FCRA to expand the permissible uses of credit report data, further encourage the accuracy of reported information, and give consumers new opportunities to oversee the use of information about them.[2] The amendments were enacted following years of hearings and debate and continued to reflect the careful balancing of commercial and consumer interests that was the hallmark of the original statute.

However, by 1996 a rising tide of state-level privacy legislation was threatening to disrupt the balance by subjecting key elements of the increasingly *national* credit reporting system to inconsistent state standards. Thus, a critical component of the 1996 amendments that was intended to preserve the national reporting system was the preemption of state and local laws that would impact specific core elements of the credit reporting system.[3] However, in the face of ongoing, rapid, and often dramatic changes in

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[1]Fair Credit Reporting Act of 1970, Pub. L. No. 91-508, 84 Stat. 1114 (codified at 15 U.S.C. §§ 1681-1681t).

[2]Consumer Credit Reporting Reform Act of 1996, enacted as title II, subtitle D, chapter 1of the Omnibus Consolidated Appropriations Act for Fiscal Year 1997, Pub. L. No. 104-208, 104th Cong., 2d Sess. §§ 2401-2422 (Sept. 30, 1996) (codified at 15 U.S.C. §§ 1681-1681t).

[3] The 1996 amendments preempted those elements of the FCRA that were considered most important for preserving a voluntary, market driven credit reporting system that protected consumer privacy but also supported widespread access to credit. Specifically, Congress prohibited state laws dealing with:

technologies and markets, Congress provided that preemption would expire on January 1, 2004. The compromise ensured that there would be both an opportunity and a need to assess the impact of imposing uniform national standards and to reevaluate the FCRA in an evolving national market.

As the January 1, 2004 deadline nears, some privacy advocates and legislators are urging Congress to drop federal preemption from the FCRA and allow states to regulate the central elements of credit reporting. Abandoning uniform national standards would mark a radical change in a credit reporting system that has evolved almost entirely without state or local regulation of its core functions. Such a step puts at risk the existing national reporting system and all of the benefits that flow from it as the foundation for the most dynamic consumer and mortgage credit markets in the world. Preemption should therefore not be abandoned without assessing carefully (1) how well the current national credit reporting system under the federal FCRA has served the American public and economy, and (2) the risks to consumers and commerce of subjecting that national system to state and local regulation that could lead to significant new restrictions on credit reporting.

There has been surprisingly little comprehensive study of the overall impact of the robust credit reporting system that has evolved in the United States. In two recent reports I teamed with my colleagues Fred Cate, Robert Litan and Peter Wallison in an effort to fill that gap.[4] I will provide both reports to the committee for its use. All of the relevant economic analyses, case studies, policymaker statements and government and industry

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1. Responsibilities of those who furnish data to be included in a credit report.
2. Responsibilities of persons who take adverse action based on a credit report.
3. Time to investigate and take appropriate action regarding disputed credit report information.
4. Time periods for which specific items of adverse information may be included in consumer credit reports.
5. Sharing of information—not just from credit reports—among affiliates.
6. Use of credit report data for "prescreening" credit information for the purpose of marketing credit or insurance opportunities to consumers, provided that credit bureaus establish and publish a toll-free telephone number that consumers can call to opt out of prescreening.
7. Notices to be included with prescreened solicitations.
8. Summary of consumer rights to be provided to individuals.

[4] Fred Cate, Robert Litan, Michael Staten and Peter Wallison, *Financial Privacy, Consumer Prosperity and the Public Good: Maintaining the Balance*, AEI-Brookings Joint Center for Regulatory Studies, April, 2003; Michael Staten and Fred Cate, "The Impact of National Credit Reporting Under the Fair Credit Reporting Act: The Risk of New Restrictions and State Regulations," mimeo, May, 2003.

reports that we examined pointed to one conclusion: The balance struck by the FCRA has facilitated the most robust credit information system in the world. That credit reporting system underpins the most competitive consumer and mortgage credit markets in the world. The system is unique in achieving a remarkable combination of (a) widespread access to credit across the age and income spectrum, (b) relatively low interest rates on secured loans (e.g., home mortgages, automobiles), (c) exceptionally broad access to open-end, unsecured lines of credit (e.g., bank credit card products) and (d) relatively low default rates across all types of consumer loans.

The following sections present some highlights of our findings. Although the discussion focuses primarily on consumer and mortgage credit markets, it should be noted that the credit reporting system also directly benefits markets for insurance, apartment rentals, cell phone service contracts, utilities, and a variety of other types of transactions.

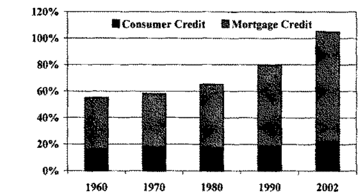
II. Benefits that Flow from the Existing National Credit Reporting System

1. Consumer Access to Credit

Broader Credit Access Across the U.S. Population. Consumer and mortgage credit underpins much of the consumer spending that accounts for over two-thirds of U.S. gross domestic product and has been a key driver of U.S. economic growth. In 2001, 75 percent of U.S. households participated in the consumer and mortgage credit markets. Sixty-eight percent of U.S. households owned their own homes, and nearly two-thirds of these homeowners had some type of mortgage loan. Nearly a third of all households had automobile loans or leases. About 73 percent of all households owned at least one general purpose credit card (e.g., Visa, MasterCard, Discover, American Express) in 2001. The average U.S. consumer-borrower had eleven open accounts (seven credit cards, four installment or real-estate-secured loans). Credit market participation is remarkably wide and deep.

Consumer Credit and the U.S. Economy. The importance of consumer credit markets to the strength and resiliency of the U.S. economy is a direct consequence of the credit reporting system. U.S. credit markets facilitate and extend economic expansion by reducing liquidity constraints. Credit markets help to translate consumer optimism into real economic activity. Consumer credit allows households to transfer consumption from periods where household income is high to periods where income is low. U.S. credit markets are the most efficient in the world at allowing households to smooth their consumption patterns over time, rather than postpone major purchases until incomes and asset holdings build to sufficient levels.

Figure 1
U.S. Consumer and Mortgage Credit as a Percentage of Disposable Income (1960-2002)



Source: Federal Reserve Board, Statistical Release Z 1 *Flow of Funds Accounts of the United States*

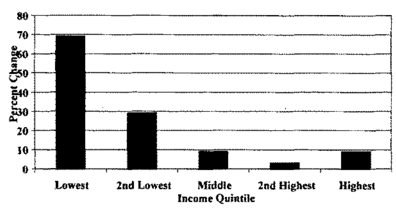
Credit also provides a "bridge" to tens of millions of households that can sustain them through temporary disruptions and declines in incomes. Credit markets that make loans accessible across large segments of the population provide a cushion that helps to neutralize the macroeconomic drag associated with these events, lowering the risk of outright recession, and reducing the magnitude of downturns when they do occur.

A recent study of 43 countries found that total bank lending to the private sector (scaled by country GNP) is larger in countries (and default rates are lower) where information sharing is more solidly established and intense.[5] The macroeconomic benefits from smoothly functioning credit markets can be linked back to the establishment of a comprehensive system for sharing consumer borrowing and payment histories.

[5] Tulio Japelli and Marco Pagano, "Information Sharing, Lending and Defaults: Cross-country Evidence," *Journal of Banking and Finance*, Vol. 26, 2002 pp 2017-2045.

Impact of Credit Reporting on Traditionally Underserved Americans. Equally remarkable is the increased access to credit across the income spectrum over the past three decades. Figure 2 displays the change in the percentage of U.S. households that used non-mortgage credit between 1970 (the year before the FCRA took effect) and 2001. The largest gains were in the lower end of the income spectrum. The proportion of households in the lowest fifth of the income distribution who had access to consumer credit jumped by nearly 70 percent over the period. Accessible credit information "democratizes" financial opportunity.

Figure 2
Change in the Proportion of U.S. Households Using Non-Mortgage Credit (1970 vs. 2001)



Source: Federal Reserve Board, Surveys of Consumer Finances.

The U.S. credit reporting system helps families break the stubborn cycle of low economic status from generation to generation. Credit is essential to home ownership, which is one of the most important steps in the accumulation of wealth. Home ownership rates among younger households vary substantially across developed countries, due in large part to differences in credit reporting. Lenders in the United States, Canada, and the United Kingdom can require less collateral (i.e., a lower down payment) as a hedge against the likelihood of default because borrower credit histories are more complete. These countries are among the leaders in terms of home ownership among younger households. In contrast, in countries where the exchange of credit history data is far more limited (e.g., France, Italy and Spain) down payments are higher and the degree of home ownership among younger households is significantly lower.

***Table 1:* Home ownership Rates Among Younger Borrowers**

Country	% Home ownership Among Population Aged 26-35	Average % Downpayment, 1991-1995
United States	49.3	11
United Kingdom	63.8	5
Spain	40.0	20
France	35.0	20
Italy	23.2	40
Germany	18.5	20

Source: Maria Concetta Chiuri and Tullio Jappelli, "Financial Market Imperfections and Home Ownership: A Comparative Study," manuscript, Department of Economics, Universita di Salerno, 2002.

These benefits of credit reporting are especially great for minorities. Between 1989 and 1998, home ownership rates rose more sharply for African Americans, Hispanics, and lower-income families than for other groups, but only a small part of these gains were attributable to improvements in their incomes or economic circumstances. Innovation among mortgage lenders in terms of risk measurement and the ability to develop and tailor new products for specific population segments accounted for much of the gains, all of which depended upon a robust credit reporting system.

2. More Accurate Decision-Making

Because credit reports are compiled over time, from a wide range of sources, and updated daily, creditors (as well as insurers, employers and other businesses with a permissible purpose) can see a far more complete picture of present *and* past credit behavior. These data, reflecting a borrower's own past payment history, replace face-to-face attempts to evaluate character and capacity (common a generation ago) with a less invasive, more accurate assessment based on documented prior behavior. Lending decisions are faster and more equitable. There is less opportunity for the loan decision to be influenced by factors other than how the borrower has handled credit in the past, and standardized credit report data make it easier for regulators to verify compliance with anti-discrimination and other lending laws.

Credit reporting thus improves the performance of the entire market, lowering the costs of making credit available and increasing the number of Americans who qualify for credit. As Federal Reserve Board Chairman Alan Greenspan has noted, "There is just no question that unless we have some major sophisticated system of credit evaluation continuously updated, we'll have very great difficulty in maintaining the level of consumer credit currently available, because clearly without the information that comes from credit bureaus and other sources, lenders would have to impose an additional risk premium – because of the uncertainty – before they make such loans. . . or not make those loans at all."[6]

Furthermore, credit reports (and the scoring models they make possible) allow lenders to be proactive in *preventing* debt problems, even for existing accountholders. By

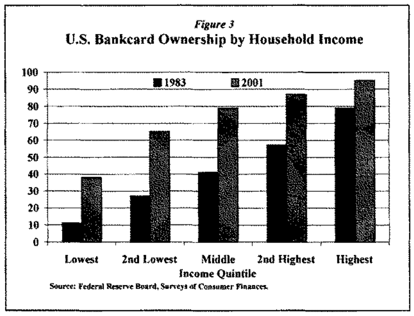
[6] Testimony of Alan Greenspan before the U.S. House Financial Services Committee, April 30, 2003.

providing a comprehensive picture of all of the borrower's credit accounts, credit report data allow creditors to prevent overextension. Consequently, U.S. delinquency rates are remarkably low. In the fourth quarter of 2002 only 3.9 percent of all mortgage borrowers in the United States were delinquent 30 days or more. Only 4.6 percent of all credit card borrowers were delinquent 30 days or more on their accounts. Sixty percent of U.S. borrowers *never* had a payment delinquent 30 days or more in the previous seven years.

Moreover, the share of household income devoted to debt service is remarkably similar across all income groups, suggesting that previously underserved groups are not generally taking on more new credit than they can handle. As a group, households in the lower two-fifths of the income distribution do not carry greater debt burdens than higher income households. Robust, national credit reporting has thus not only made it possible for more people to have access to more credit, but to do so without a substantial increase in defaults.

3. Enhanced Competition

Because it dramatically reduces the cost of assessing the risk of new borrowers, credit report information encourages entry by new lenders and greater competition. Access to national credit report data and the ability to use them to "prescreen" applicants, for example, has transformed the credit card market by facilitating efficient national competition. In the face of that competition, consumer choice has increased dramatically; no-fee cards and cards offering frequent traveler miles or cash-back rebates are now commonplace. Credit card interest rates have plummeted, relative to the late 1980s. The number of Americans with access to credit cards has soared. The percentage of U.S. households owning at least one general-purpose bank credit card has increased from 43 percent in 1983 to 73 percent by 2001 (Figure 3). Overall, 30 million more U.S. households had a bankcard in 2001 than in 1983.



Laws that inhibit the assembly of comprehensive credit reports act as a barrier to competition by giving the dominant incumbent lender a monopoly over the information it possesses about its customers, and denying new market entrants the information needed to provide and market competitive services. In Europe, where comprehensive credit reports are unavailable in several countries, financial services are provided by far fewer institutions—*one-tenth* the number that serve U.S. customers. In France, the European Union country with some of the strictest financial privacy laws, seven banks controlled more than 96 percent of banking assets in the late 1990s. The absence of comprehensive credit histories restrains competition and makes it easier to hold customers and capital captive.

Ownership rates of unsecured credit cards are vastly higher in the United States than in Europe. A Morgan Stanley Dean Witter report highlights the critical difference that available credit histories make, noting that "[t]he biggest obstacle to new entrants" in many European countries "is the lack of a centralized credit bureau."

Table 2: **Credit Card Ownership, 1997 (per 1000 people in population)**

Country	Superpremium + Premium	Corporate	Standard	Total
United States	650.4	20.9	945.0	1616.3
U.K.	91.3	22.5	546.7	660.5
Belgium	53.0	6.9	197.4	257.3
Netherlands	38.3	9.4	195.9	243.5
Spain	26.5	4.3	212.0	242.8
Sweden	44.2	46.4	85.8	176.4
Germany	39.7	4.6	127.8	172.0
Italy	18.2	9.7	109.1	137.0
France	25.1	3.1	68.3	96.6

Source: Lyn C. Thomas, David B. Edelman, and Jonathan N. Crook, *Credit Scoring and its Applications*, Society for Industrial and Applied Mathematics, Philadelphia, 2002, p 212.

4. Speed and Convenience

The depth of information in U.S. credit reports enhances the speed of credit and other financial service decisions. Even very significant decisions about financing a college education or a new home or writing automobile or homeowners insurance are often made in a matter of hours or minutes, instead of days and weeks as is the case in most other countries, because credit history data is readily accessible. In 2001, 84 percent of automobile loan applicants in the United States received a decision within an hour; 23 percent of applicants received a decision in less than 10 minutes. Many retailers open new charge accounts for customers at the point of sale in less than two minutes. According to Federal Trade Commission Chairman Muris: "Many fail to appreciate that the average American today enjoys access to credit and financial services, shopping choices, and educational resources that earlier Americans could never have imagined. . . . What I personally find most astounding is . . . the 'miracle of instant credit.'" Muris concluded: "This 'miracle' is only possible because of our credit reporting system."[7]

5. Catalyst to Productivity Growth

Portable credit "reputations" give consumers greater mobility and enhance their ability to respond to change. By increasing our mobility as a society, the credit reporting system under the FCRA has improved the efficiency of U.S. labor markets, so that structural shifts within the economy can cause temporary disruptions without crippling long-term effects. There is less risk associated with severing old relationships and starting new ones, because objective information is available that helps us to establish and build trust in new locations more quickly. Economist Walter Kitchenman has described the "almost universal reporting" of personal information about consumers as the "secret ingredient of the U.S. economy's resilience."[8]

In contrast, more restrictive, and inconsistent, credit reporting laws prevent European consumers from taking full advantage of their complete credit histories. The fact that credit *information* is not mobile restricts the mobility of *consumers*, because of

[7] Timothy J. Muris, *Protecting Consumers' Privacy: 2002 and Beyond*, Privacy 2001 Conference, October 4, 2001.
[8] Walter Kitchenman, *U.S. Credit Reporting: Perceived Benefits Outweigh Privacy Concerns*, The Tower Group, 1999.

the resulting difficulty of obtaining credit from new institutions. In fact, European consumers, although they outnumber their U.S. counterparts, have access to *one-third* less credit as a percentage of aggregate personal income.

6. Reduced Costs

Comprehensive credit reports have improved the competitiveness and efficiency of credit markets, led to powerful improvements in risk-management technology (like credit scoring), and created more product choices and better tools for assessing and managing risks, thereby avoiding delinquencies and defaults. *All of this ultimately lowers the cost of credit to consumers.*

Reliable, centralized, and standardized consumer credit information makes it possible to pool consumer loans and then sell them to investors. Such securitization of home mortgages, auto loans and credit card balances has made hundreds of billions of dollars of additional funds available to loan to consumers. A Tower Group study concluded that U.S. mortgage rates are two full percentage points lower than in Europe because of securitization in the mortgage loan market. Consequently, American consumers save as much as *$120 billion* a year on $6 trillion of outstanding mortgages because of the efficiency and liquidity that credit report data make possible. By making refinancing easy and fast, the U.S. credit reporting system also allowed eleven million homeowners to refinance their home mortgages to take advantage of lower interest rates during just a 15-month period in 2001 and early 2002, thereby saving an estimated $3.2 billion *annually* in mortgage payments.

7. Public Safety and Security

Credit reports have long proved a useful and convenient way to check for past criminal convictions when employing school bus drivers, child-care workers, security guards, and people to fill other sensitive positions. They provide an increasingly important tool for preventing financial fraud, because they contain a comprehensive picture of an individual's financial dealings, information that can be used to cross-check and verify identities. They are also becoming an increasingly potent weapon in the fight against identity theft and terrorist threats.

III. The Risk of a Balkanized, State-level System of Credit Reporting

Proposals to abandon preemption threaten the diverse array of benefits that flow from the current credit reporting system under the FCRA. Virtually all of the benefits to individuals and the economy from the current U.S. reporting system result from its national character. National credit reporting made possible national competition in the market for credit and other financial services. Moreover, U.S. consumers are remarkably mobile, thanks in part to the ubiquitous availability of credit reports. Regulating credit histories state-by-state would ill serve consumers as they move, commute, and deal with businesses across state lines. It would leave holes (potentially large ones) in credit files, which would greatly reduce the reliability of credit reports. A balkanized credit reporting system would make a consumer's creditworthiness and credit opportunities depend on the state in which he/she lived.

While most aspects of credit reporting are vulnerable to the higher costs of inconsistent state or local regulations, some are especially at risk. I list three particularly sensitive areas below.

Voluntary Reporting is Vulnerable: Because no one is *required* to provide information to credit bureaus, if furnishers of information faced significant compliance burdens or liability, as would be the case if complying with separate and even inconsistent state laws, they would be more likely to stop contributing the information. Imposing liability for errors or significant additional burdens on the furnishers of consumer data to credit bureaus would discourage firms from reporting. Even the absence of a small amount of relevant information from credit reports could dramatically reduce their usefulness and lead to less accurate credit decisions and less access to credit for people who need it most.

Limits on Reporting of Adverse Information Dilute the Value of the Credit File: The 1996 amendments also precluded states from regulating when data would be considered "obsolete" and therefore could not be included in credit reports. Currently, derogatory information must be excluded from credit reports after seven years (with the exception of a notice of bankruptcy, which may remain for ten years). Attempts to accelerate obsolescence determinations, or modify the range of adverse information that could be reported would undermine the predictive value of credit reports.

Opt-In Rules Dampen Competition: The 1996 amendments to the FCRA explicitly authorized the use of credit report data for prescreening offers of credit and the sharing of data across affiliated companies, provided that consumers are given an opportunity to opt out of that sharing. Proposals to move to an *opt-in* system are certain to impose new costs on consumers because opt-in requires each company to gain explicit consent from each consumer prior to using personal information to target its marketing efforts. Opt-in is especially inefficient in the context of credit granting because is requires that every consumer be contacted, even though only a portion will qualify for an offer of credit. Those who do qualify will have to be contacted twice – once for permission to use the data to evaluate them, and again to make the offer. The consensus of studies and company experience is that *conditioning the use of information on opt-in consent is tantamount to banning the use outright.*

This makes an opt-in system for prescreening and sharing credit report data among affiliated companies an especially great impediment to the emergence of new market entrants and the development of innovative products and services, which, in turn, threatens the lower prices and enhanced choice that competition facilitates. Opt-in for prescreening and affiliate-sharing restrains competition and the benefits that flow from it.

Conclusion

Continued preemption of state and local credit reporting rules will preserve a truly national credit reporting system. As Congress deliberates whether to reauthorize the federal preemption, the threat of unraveling the remarkable gains to individual consumers achieved under our existing national reporting system should give policymakers pause. Compared to most other developed countries, the U.S. national credit reporting system has helped make it possible for a higher proportion of Americans to live in their own homes, drive their own cars, and afford college educations. It has greatly increased the number of Americans who now qualify for credit, insurance, and other financial services, and increased the confidence of providers in meeting the needs of previously underserved populations. The credit reporting system, undergirded by the FCRA, has helped to break down geographic and economic barriers, so that virtually all Americans can choose from financial services provided by competing businesses without regard for location. Credit reporting has had a literally transforming effect on the lives of less well-off individuals, young adults, and those located in small towns and rural areas. "Democratization" describes a broad and beneficial social effect, but the greatest measure of the impact of robust, national credit reporting is measured in the millions of individual lives improved.

I thank you for the opportunity to appear today and would be happy to answer questions.

Biography

Michael E. Staten
Distinguished Professor and Director, Credit Research Center
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Ph.D. Purdue University, 1980, Economics
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B.S. University of Texas at Arlington, 1976, Economics, Highest Honors

As director of the Credit Research Center since 1990, Prof. Staten has designed and conducted projects on a wide range of policy-oriented issues involving markets for consumer credit and financial services. His most recent research projects have examined the causes and consequences of personal bankruptcy, the role of comprehensive credit bureau data in expanding access to credit, the economics of subprime loan markets, and the impact of privacy regulations on the products and customer service offered by retail financial services firms.

Since its founding at Purdue University in 1974, the Credit Research Center has built a national reputation for its analysis of the economics of consumer credit markets. The Center's research product is used by the U.S. Congress, regulatory agencies, legislatures, the credit industry, consumer groups and the court system. The Center moved to the McDonough School of Business at Georgetown University in 1997. More information is available on the Center's website at www.msb.edu/prog/crc.

Prof. Staten has presented expert testimony on credit and insurance issues before committees of the U.S. House and Senate and various state legislatures. He has published numerous articles in various professional journals. In 1997 his book *Consumer Attitudes Toward Credit Insurance* (with John M. Barron) won the American Risk and Insurance Association's Elizur Wright Award for its contribution to the risk management and insurance literature.

Recent Publications Relevant to Credit Reporting:

John Barron and Michael Staten, "The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience," forthcoming in *Credit Reporting Systems and the International Economy*, edited by Margaret Miller, MIT Press, spring 2003.

Michael Staten and Fred Cate, "The Impact of Opt-in Rules on Retail Credit Markets: A Case Study of MBNA," forthcoming, *Duke Law Journal*, 2003.

Fred Cate, Robert Litan, Michael Staten and Peter Wallison, "Financial Privacy, Consumer Prosperity and the Public Good: Maintaining the Balance," AEI-Brookings Joint Center for Regulatory Studies, April, 2003.

United States House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

Hearing on "The Importance of the National Credit Reporting System to Consumers and the U.S. Economy"

May 8, 2003

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Introduction

Chairman Bachus, Congressman Sanders, and other distinguished members of the Financial Services Committee, I thank you for your invitation to testify concerning reauthorization of the Fair Credit Reporting Act. The FCRA was the first data privacy statute enacted in the United States, and our history under this statute can teach us important lessons about how best to proceed in considering its reauthorization.

My testimony today will provide a brief historical and analytic background for the FCRA. I will discuss the principles for financial privacy legislation that I support as a law professor and that also reflect my experience as a government official on financial privacy and related issues. I will then apply these principles of good legislation to preemption and other FCRA issues before the Committee.

Background of the Witness

I am currently a Professor of Law at the Moritz College of Law of the Ohio State University. I live in the Washington, D.C. area and am Director of the school's Washington, D.C. summer internship program.[1]

It is a particular pleasure for me to appear before this Committee because my first academic focus when I entered law teaching in 1990 was in the area of financial services law. I have often taught in the area of banking regulation, and have published law review articles on the topic in journals such as the Duke Law Journal and Virginia Law Review. I am a past Chair of the American Association of Law Schools Section on Financial Institutions and Consumer Financial Services.

I have also made a special academic study of the issue of financial privacy, and in fact received an Ameritech Faculty Fellowship in 1997 to study "The Role of Law in Assuring Financial Privacy." I have written four law review articles and a book chapter specifically on the topic of financial privacy,[2] and have addressed related issues in numerous other writings, most of which are available at www.peterswire.net.

In March, 1999 I was named the Chief Counselor for Privacy in the U.S. Office of Management and Budget. In that position, I was intensively involved in Administration policy during consideration of Title V of the Gramm-Leach-Bliley Act, which was of course enacted in November, 1999. I was also deeply involved in development of the bill that became the Consumer Financial Privacy Act, H.R. 4380, in the spring of 2000. Since returning to law teaching, I have written an article entitled "The Surprising Virtues of the New Financial Privacy Law", which was published last year by the Minnesota Law Review. That article presents my views on affiliate sharing, notice, and other issues in the wake of the Gramm-Leach-Bliley Act.

The History of FCRA as an Effective Legal Regime

In watching the intense controversies that exist for FCRA reauthorization, I am primarily struck by the large degree of consensus on the basic structure of the Act. In most respects, both industry and consumer advocates see the FCRA as a model that is substantially superior to the systems that exist in other countries.

The FCRA without a doubt has helped to build the enormously effective system for granting credit that exists today in the United States. Today a car loan typically takes a few minutes, and a mortgage loan is no longer the lengthy process that it was when my family and I bought our first house 17 years ago. The vast majority of transactions are rapid and accurate for both lenders and consumers. Most consumer finance markets are intensely competitive, with thousands of competing credit cards offering a dazzling array of product features.

From the consumer perspective, the FCRA has provided legal safeguards that assure that the advantages of price, speed, and variety of products actually reach the greatest possible number of consumers. Anyone involved in FCRA reform should go back and read some of the hearings from the 1960s or the Arthur Miller book[3] that described the terrible problems in the credit-granting system in the period leading up to passage of the FCRA in 1970. Quite simply, people's lives were being ruined. There were numerous, documented horror stories of people being turned down for jobs and mortgages due to erroneous credit reports. Because consumers have no direct relationship with credit reporting agencies, there was no effective way for individuals to discover the mistakes and make changes. In most instances, applicants would never learn why they were being rejected for job after job or loan after loan.

The Fair Credit Reporting Act of 1970 addressed these problems, and in so doing formed the foundation for the vastly improved consumer credit markets we enjoy today. A basic opt-in rule applies to credit reports – consumer consent is required before a lender or employer can see the credit report. Consumers gained the right to see their credit histories, and to correct mistakes. Consumers now receive notice of adverse actions based on a credit report. The Federal Trade Commission became a watchdog agency on the credit reporting agencies. Private rights of action back up FTC enforcement.

In short, a rigorous legal regime created accountability in the credit granting system. The people with the most at stake in accuracy – the individuals – became the watchdogs to make sure that their own credit history remained accurate. With this foundation of accurate information, credit grantors enjoy a much lower risk when making loans. Effective checks and balances in the system, backed up by legal enforcement, have created the United States credit system that performs so well in comparison to the systems in other countries.

The credit granting system, at heart, is a vast combination of information flows. The FCRA was created in 1970 in response to the development of huge mainframe computers in the three emerging national credit reporting agencies. The 1996 amendments were passed just as the Internet was first being used for commercial activity. The Committee's challenge today, in my view, is how to continue the success of the FCRA in the networked computer systems of today and the almost unimaginable systems of a decade from now. The checks and balances that have served us well to date will, in my view, inevitably need adjustment as the underlying technologies change. Reauthorization of the FCRA is thus a work in progress, and not a task that can be finished this year for all time.

Principles for Assessing Legislation

In signing the Gramm-Leach-Bliley ("GLB") Act in late 1999, President Clinton tasked OMB (where I worked), Treasury, and the National Economic Council to draft additional legislation to finish the unfinished business of financial privacy from GLB itself. That policy process resulted in the President's announcement the following April of the proposal that became H.R. 4380, the Consumer Financial Privacy Act. Portions of that bill were incorporated into Chairman Leach's bill, H.R. 4585, the Medical Financial Privacy Protection Act, which was favorably reported by this Committee to the House.

Based on my participation in this process and my academic work on financial privacy, I offer the following principles for assessing legislation in this area. I begin with an overall effort to understand the costs and benefits of various flows of information through the financial system.[4] The following principles reflect my experience in assessing legislative proposals:

(1) *Match reasonable customer expectations.* This is the most general principle, but perhaps the most useful. If you create systems where people say "that's just not fair" then you are likely to have an unstable system that will require costly amendment over time. The credit reporting system applies to many millions of individuals, who cannot bargain effectively with credit reporting agencies on how their data will be handled. The simplest test is often to put yourself in the position of an individual with a problem in the system, and ask what would seem reasonable to you as that individual.

(2) *Adjust the level of protection to the sensitivity of the data.* We now have extensive experience on types of data that Americans consider most sensitive. Medical and financial data are at the top of the list, based both on polling and on the experience in the political system. Since 1970 there has been a general opt-in standard for sharing

credit histories. The medical privacy rule under the Health Insurance Portability and Accountability Act, which just last month entered into effect, similarly has an opt-in rule. Other information is less sensitive. In the Consumer Financial Privacy Act, for instance, we proposed opt-in protection for medical data and personal spending habits, but a less strict opt-out rule for target marketing activities.

(3) *Ensure that appropriate security and related safeguards are in place.* Having good privacy policies is not enough. The policies must also be implemented effectively in the real world. In GLB, for instance, there are information security guidelines and other important safeguards such as re-use limits, requirements of confidentiality contracts for principal-agent relationships, and so on.

I believe the Committee should determine the extent to which credit reporting agencies and entities that receive credit reports are already under the security guidelines created by GLB. To the extent they are not, the Committee might wish to consider whether FCRA reauthorization should address the issue. Recognition of the importance of information security standards largely post-dates the 1996 amendments. As part of our overall greater attention to identity theft and the risks that come from inappropriate disclosure of sensitive personal information, there may be sensible safeguards that can be created on the security side for organizations governed by the FCRA.

(4) *Create appropriate exceptions to ensure that privacy laws do not inadvertently burden important economic activity.* All of our privacy laws allow data flows in some instances without the need for customer choice, such as in the case of court orders. My view is that the exceptions under GLB, Section 502(e), generally work quite well. When we drafted the Consumer Financial Privacy Act, we proposed a new exception to assure that data could be used for customer service activities within a holding company. By contrast, my experience with the European Union Data Protection Directive, on which I wrote a book, is that other countries have sometimes failed to create needed exceptions, with harmful effects to the overall system.

(5) *Federalism.* Legislation drafted in Congress should of course consider which tasks should be handled at the state or federal level. This topic is the difficult question of when federal law should preempt state law, to which I return below.

(6) *Create a system that works over time.* We should try to do more than create a good static system, one that works for today. We should also create a good dynamic system, one that is likely to work well over time. I return to this principle below in my discussion of preemption.

Preemption and Creating a System That Works Over Time

I now turn to the linked issues of preemption and how to create an effective system for credit reporting over time.

The essential argument for preemption is systems efficiency. Credit information flows from all fifty states to the credit reporting agencies. The three key credit reporting agencies are national and international in scope. Data then flows from these agencies to lenders and other users of credit reports in all fifty states. The basic operation of the system is thus national. The more that state and local laws alter the fundamental operations of the systems themselves, the greater the burden on participants in this national system.

There are two traditional arguments for a role for the states in the process. The first is the well-known idea that states can serve as a laboratory for experimentation. A current example of this comes from the anti-spam legislation that Congress is now considering. Although there have been some anti-spam proposals in Congress for several years, the center of legislative experimentation has been in the states, many of which have passed anti-spam laws. Some of these laws have worked better than others, and the most successful ones are now serving as models for possible federal legislation. Another current example is the do-not-call list for telemarketing. Again, the states experimented with legislation establishing do-not-call lists. After some of these state laws had proven successful, the Federal Trade Commission moved forward with the national do-not-call list that was approved recently. In both of these important areas of consumer concern, the experience with state laws was an essential step in considering establishment of national consumer protections.

The role of the states has historically been especially strong for consumer protection issues. Consumer protection legislation has repeatedly been passed to alter the common law of contracts, itself a subject of state jurisdiction. This Committee is well-versed in this special role for the states in consumer protection, as shown for instance in the Riegle-Neal provisions that permit the states to continue their role in consumer protection even in the era of nationwide banking. Congress chose not to preempt stronger state laws for privacy in the Gramm-Leach-Bliley Act and the Health Insurance Portability and Accountability Act of 1996 ("HIPAA").

In addition to these two traditional arguments – laboratories for experimentation and the state role in consumer protection – my experience in government and in the study of privacy laws suggests a third, important reason to consider limiting the scope and duration of preemption in the consumer credit area. Limited preemption, in my view, plays a key role in bringing the players to the table, so that all perspectives are considered in the revision of legislation.

The recent history of privacy legislation shows that privacy protections have been enacted almost exclusively when they were part of a larger legislative package that was strongly desired by key industry groups. The medical privacy rule arises from the passage of HIPAA in 1996. In that bill, industry groups strongly supported the "administrative simplification" provisions that would reduce costs by requiring payments to be in standard electronic formats. Congress decided that security and privacy safeguards should be created at the same time that the medical system was shifting to electronic records. The telecommunications privacy rule arises from the Telecommunications Act of 1996. That bill, which restructured so much of the telecommunications industry, included the so-called CPNI (customer proprietary network information) privacy rule. In 1999, this Committee participated in the creation of the

Gramm-Leach-Bliley Act. The privacy protections of Title V were once again included as part of an overall package that was strongly desired by industry stakeholders.

The same pattern holds true today. We simply would not be having the same discussions on how to update consumer protections in the credit reporting system except for the desire for legislation on the part of the affected industry. The push for reauthorization creates a forum for examining how to create an FCRA that is appropriate for today and the future.

The focus on the future is especially important because the FCRA is a statute that regulates information flows in an era of rapid changes in information flows. Whatever is appropriate in January, 2004 will almost certainly be different for the changed information systems of January, 2012. We have already seen rapid change since 1996 in the area of identity theft. It is difficult or impossible to predict what emerging information challenges will arise in the coming years.

To pull the themes together on preemption, a core goal of reauthorization is to assure the efficient operation of the national credit reporting system. State laws that require costly re-engineering of the national system are the ones that are the best candidates for preemption. On the other hand, the closer one comes to actual customer relations, the more that localized approaches relevant to that individual and community are likely to be appropriate.

In addition to possible limits on the subject matter scope of preemption, I think the case is particularly strong for limiting the duration of federal preemption. The overall policy goal facing this Committee is how to build a credit reporting system that works both today and in the future. The rise of identity theft shows how new problems will arise as information systems change. Limiting the duration of preemption will likely spur a better public policy process when reauthorization is next due.

Matching Preemption Rules to the National Market

The analysis here supports federal preemption for issues that would impede national efficiencies in systems operations, and greater tolerance for state law experimentation for issues that apply predominantly within each jurisdiction. Reasonable people may differ on which provisions deserve to be more "national" or "local." I offer a few observations here based on my current understanding of how the systems are likely to operate.

One strong candidate for preemption would appear to be a firm offer of credit or insurance. The offer is likely to be made to multiple states, drawing on a national credit reporting agency and often a national financial institution that is making the offer. Suppose, for instance, that one state required a particular double-check before the firm offer could be made. The programmers for the credit reporting agency or financial institution would then need to write costly programming to screen how all of the files would be handled. If these facts are correct (and I base my comments on prior site visits to credit card companies and other financial institutions), then state laws governing pre-screening could easily place a significant burden on a national set of operations. (To the extent that additional consumer protections are appropriate for the topic of pre-screening – and the current statute really does not provide privacy standards for how the pre-screening is done – then such protections would be a suitable topic for the Committee to address in the federal reauthorization process.)

My current view is different, however, for state laws concerning those who furnish information to the credit reporting agencies and those who use credit reports. The furnishers and users are companies that have chosen to do business in a particular state. They already comply with tax laws, consumer protection laws, and numerous other rules that may be specific to that state. As to furnishers, there may be a useful role for state experimentation when it comes to the issue of ensuring that incorrect information does not get sent repeatedly to the credit reporting agencies. A recurrent problem, both for private furnishers and for public records, is that an individual may correct data at the credit reporting agency. The same mistake, however, is often re-inserted in the individual's record by a private furnisher or a state agency that has not corrected its public record. Similarly, on the user side, it may be an appropriate use of the state police power to experiment with information security standards or other measures that ensure that credit reports do not fall into the wrong hands. For both furnishers and users, the state laws would apply to companies that have availed themselves of that state to do business.

The rapidly changing nature of the problem provides a different reason to believe that Congress should not preempt experimentation in the area of identity theft. It is difficult to have confidence in how to combat this growing problem. With our imperfect understanding of the problem, there is quite possibly a useful role for state experimentation. In addition, the nature of our authentication and other information systems is clearly in rapid transition. Writing a permanent preemption into the FCRA would run the risk of freezing us into a limited and likely sub-optimal set of responses to this problem.

Two Substantive Issues for Further Attention

Based on my ongoing privacy research, I will briefly discuss two additional areas that merit attention as part of the FCRA reauthorization process.

Medical privacy. I think it is quite possible that Congress should consider updating the treatment of medical records under the FCRA. Medical privacy occupied a large fraction of my time as Chief Counselor for Privacy in OMB. The FCRA today has only limited provisions that govern the use of "medical information" in credit reports. The term "medical information" is considerably narrower in scope than the "protected health information" that is covered under the HIPAA medical privacy rule. In the FCRA, the term covers only "information or records obtained, with the consent of the individual to whom it relates, from licensed physicians or medical practitioners, hospitals, clinics, or other medical or medically related facilities." This "medical information" cannot be furnished "for employment purposes, or in connection with a credit or insurance transaction", except with the individual's consent.

The HIPAA definition of "protected health information" is considerably broader than the FCRA definition of "medical information." For instance, HIPAA applies to medical records beyond those gained "with the consent of the individual to whom it relates." The HIPAA rule itself, as amended in 2002, does not require patient consent as part of medical treatment. Many states do not require consent, although some do. A large portion of doctors' records, therefore, would not appear to fall within the plain language of the FCRA definition. In addition, HIPAA is broader because it applies to protected health information that comes from essentially any health care provider (not just the narrower list in the FCRA), as well as from a health plan or health care clearinghouse.

In the limited time available since I was called as a witness, I have not been able to do fact-finding on the way that medical records are used today in the credit reporting system. There is a well-known loophole in Gramm-Leach-Bliley for sharing medical information within a financial holding company. That loophole was the basis of Chairman Leach's effort in 2000 to pass H.R. 4585, the Medical Financial Privacy Protection Act. That bill on this issue was essentially identical to Section 4 of H.R. 4380, the Consumer Financial Privacy Act. Perhaps that proposal, based on inter-agency efforts that included HHS, Treasury, and OMB, would be a fruitful beginning point for bringing the FCRA more in line with the heightened protections for medical records that now exist nationally under the HIPAA medical privacy rule.

FCRA and the "Patriot II" Act. I would like to call the Committee's attention to a seriously misleading statement in the so-called Patriot II proposal. That proposal, according to press accounts, was circulated to senior Administration officials before being leaked to the press earlier this year. Section 126 of that draft legislation is entitled "Equal Access to Consumer Credit Reports." The proposal would allow law enforcement officials to get any credit report with a simple certification that they will use the information "only in connection with their duties to enforce federal law." There are no limits on re-disclosure to other agencies. There are no mechanisms at all to ensure that the credit reports will be used for the stated purpose once they are given to the government.

The seriously misleading statement is to call this "equal access" to credit reports when it is instead unprecedented access. Under current law, credit reports are *pulled at the choice of the individual*, such as for a loan or other transaction initiated by the individual.[5] The individual decides whether a credit report should be generated. The statute is full of detailed notice requirements, re-disclosure rules, and adverse event reporting. By sharp contrast, the proposed Section 126 would give the government the power to get a credit report secretly, without the consent of the individual, with no indication of adverse actions, and with a prohibition on telling the individual even after the fact that the credit report has been accessed. This is an Orwellian use of the words "equal access." In light of the disingenuous proposal to amend the FCRA, this Committee should give a detailed and public vetting to any proposal to amend the FCRA to give unprecedented access by government agencies to the sensitive data in Americans' credit histories.

Conclusion

In conclusion, I thank the Committee for holding this hearing on the role of national credit reporting system. The furious debate about the scope of preemption should not cloud the very large areas of agreement about the Fair Credit Reporting Act. Effective legal protections for consumers, including full access for individuals to their own credit histories, have helped create a far more accurate and efficient credit granting system than would otherwise have existed. A major challenge is how to ensure that effective privacy and other consumer protections accompany the rapid changes in future years in our information economy. A certain degree of experimentation by the states, and a periodic re-examination of these issues by the Congress, will likely create a better system over time than a permanent preemption of all consumer protections at the state level.

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[1] I note that I also serve as a consultant to the Washington, D.C. office of the law firm of Morrison & Foerster, LLP, on health privacy and other matters. I am presenting this testimony entirely in my individual capacity as a Professor of Law. I am not an employee of Morrison & Foerster, and am not appearing on behalf of the Firm. I have not performed work for any client on the issue of FCRA reauthorization.

[2] The articles are: "Efficient Confidentiality for Privacy, Security, and Confidential Business Information," Brookings-Wharton Papers on Financial Services (forthcoming, 2003; available at www.peterswire.net); "The Surprising Virtues of the New Financial Privacy Law," 86 Minn. L. Rev. 1263 (2002); "Financial Privacy and the Theory of High-Tech Government Surveillance," 77 Washington U. L.Q. 461 (1999) & Brookings-Wharton Papers on Financial Services; and "The Uses and Limits of Financial Cryptography: A Law Professor's Perspective," chapter in the proceedings of Financial Cryptography '97 (Springer-Verlag, 1997). The chapter on financial privacy is in Peter P. Swire & Robert E. Litan, None of Your Business: World Data Flows, Electronic Commerce, and the European Privacy Directive (Brookings, 1998).

[3] Arthur R. Miller, The Assault on Privacy: Computers, Data Banks, and Dossiers (1971).

[4] For my views on assessing costs and benefits of information flows in financial services, see Peter P. Swire, "Efficient Confidentiality for Privacy, Security, and Confidential Business Information." It is available at www.peterswire.net.

[5] Credit reports can also be shared for purposes of a firm offer of credit or insurance, subject to consumer opt-out, limited disclosure of information to the offeror, and the other detailed safeguards in 15 U.S.C. § 1681b. In addition, the FCRA currently permits disclosure to the FBI for counter-intelligence purposes, subject to numerous safeguards, 15 U.S.C. § 1681u, and disclosure subject to fewer safeguards for counter-terrorism purposes, 15 U.S.C. § 1681v. The proposal in the Patriot II Act entirely lacks the sorts of safeguards that currently exist, for instance, under Section 1681u.

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EMPLOYMENT

Professor of Law, Moritz College of Law of the Ohio State University, and Director of its Washington, D.C. summer law school program. Teaching at Ohio State, 1996 to April 1999, January semester 2001, fall semester 2002 and following. Promoted from Associate Professor to Professor in 1998.

Research focus on law of cyberspace, privacy, and computer security. Courses taught in those areas as well as corporations, torts, banking regulation, and other subjects. Editor, Cyberspace Law Abstracts of the Social Science Research Network (with Lawrence Lessig).

Consultant, Morrison & Foerster, LLP, Washington, D.C., 2001-present, on privacy, cyberspace, and related topics.

Chief Counselor for Privacy, Executive Office of the President of the United States, Office of Management and Budget. March, 1999 to January, 2001. Responsible for coordinating Administration policy on public- and private-sector uses of personal information, and served as point of contact with privacy and data protection officials in other countries. White House Coordinator for HIPAA medical privacy regulation; Coordinator, White House Working Group on legislative proposal to update wiretap and electronic surveillance laws; Member, White House Electronic Commerce Working Group; Member, Working Group on Unlawful Content on the Internet. Substantial work on computer security, financial privacy, and other topics.

Visiting Professor, George Washington University Law School, 2001-2002. Associate Professor, University of Virginia, School of Law, 1990-1996.

Associate, Powell, Goldstein, Frazer & Murphy, Washington, D.C., 1986-1990. Advocacy practice before Congress and agencies, on banking, environmental, high-technology and other issues.

Judicial clerk, to the Honorable Ralph K. Winter, Jr., United States Court of Appeals for the Second Circuit, 1985-86.

EDUCATION

Yale Law School. J.D. 1985; Senior Editor, Yale Law Journal; Program of Doctor of Civil Laws (Law and Political Theory).

Université Libre de Bruxelles, Belgium. Rotary International Fellowship, 1980-81. Student, in French, at the Institute of European Studies and in Economics.

Princeton University. A.B. 1980, summa cum laude, from the Woodrow Wilson School of Public and International Affairs, with Concentration in Economics; Phi Beta Kappa.

BOOK PUBLICATION

Peter P. Swire & Robert E. Litan, None of Your Business: World Data Flows, Electronic Commerce, and the European Privacy Directive (Brookings Institution Press, 1998).

ACADEMIC PUBLICATIONS

"Efficient Confidentiality for Privacy, Security, and Confidential Business Information," Brookings-Wharton Papers on Financial Services (forthcoming, Brookings, 2003).

"Trustwrap: The Importance of Legal Rules for E-Commerce and Internet Privacy", Hastings L.J. (forthcoming, 2003).

"State Wiretaps and Electronic Surveillance After September 11", Hastings L.J. (forthcoming, 2003) (with Charles Kennedy).

"The Surprising Virtues of the New Financial Privacy Law," 86 Minn. L. Rev. 1263 (2002).

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"Of Elephants, Mice, and Privacy: International Choice of Law and the Internet," 32 The International Lawyer 991 (1998).

"The Uses and Limits of Financial Cryptography: A Law Professor's Perspective," chapter in the proceedings of Financial Cryptography '97 (Springer-Verlag, 1997).

"Markets, Self-Regulation, and Legal Enforcement in the Protection of Personal Information," U.S. Department of Commerce, Privacy and Self-Regulation in the Information Age (1997).

"The Race to Laxity and the Race to Undesirability: Explaining Failures in Competition Among Jurisdictions in Environmental Law," Yale Law & Policy Rev./Yale J. on Regulation, Symposium: Constructing a New Federalism 67 (1996).

"Equality of Opportunity and Investment in Creditworthiness," 143 U. Pa. L. Rev. 1533 (1995).

"The Persistent Problem of Lending Discrimination: A Law and Economics Analysis," 73 Tex. L. Rev. 787 (1995).

"Safe Harbors and a Proposal to Improve the Community Reinvestment Act," 79 Va. L. Rev. 349 (1993).

"Bank Insolvency Law Now That It Matters Again," 42 Duke L.J. 469 (1992).

Litan, Swire & Winston, "The U.S. Liability System: Background and Trends," in Liability: Perspectives and Policies (Brookings, 1988).

Note, The Incorporation of Independent Agencies Into the Executive Branch, 94 Yale L.J. 1766 (1985).

Book Review, 1 Yale J. L & Pol'y 417 (1983) (reviewing Jerry L. Mashaw, Bureaucratic Justice: Managing Social Security Disability Claims).

(Note: a more complete curriculum vita is available at www.peterswire.net)

Statement by

Michael A. Turner, Ph.D.
President and Senior Scholar
The Information Policy Institute

Before the

U.S. House of Representatives
Committee on Financial Services,
Subcommittee on Financial Institutions and Consumer Credit

Concerning

"The Importance of the National Credit Reporting System to Consumers and the U.S. Economy."

8 May 2003
2128 Rayburn House Office Building

Introduction

Good morning Mr. Chairman and honorable members of the Subcommittee. I am grateful for the opportunity to testify before you today. I commend Chairman Bachus and Chairman Oxley, and Congressman Frank for their leadership on the complex yet crucial issue of the national credit reporting system.

My name is Michael Turner and I am President and Senior Scholar of the Information Policy Institute. The Institute is a non-profit, non-partisan research organization based in New York City – and is the only institution of its kind dedicated exclusively to issues involving the regulation of information, both domestically and globally.

In the past year alone, the Institute has taken its research findings to various federal, state, and international legislative and regulatory bodies on issues ranging from media ownership to trans-border data flows. We have worked with states' Attorneys General offices to craft a consumer survey on state do-not-call registries and shared the results with the FTC; we worked very closely with consumer groups to craft comments criticizing the FCC's proposed relaxation of media ownership rules; we participated in a task force on homeland security and information technology coordinated by the Markle Foundation, the Center for Strategic and International Studies (CSIS) and the Brookings Institution the results of which were later presented to Congress; we drafted a concept piece examining the impact of adopting an EU-style data regime on developing countries that was distributed at a recent APEC summit; Institute fellows generated a study measuring the economic impact of proposed financial services data restriction legislation in California; and personally, I am currently serving as an expert economic witness on behalf of a small firm in a pending antitrust suit against a multi-media giant. In short, during the past year the Institute has addressed information policy issues on the state, federal, and international levels and has consistently based its analysis on objective facts rather than any identifiable ideological predisposition.

Despite the significance of the issues the Institute has studied to date, perhaps none is as important to the entire population on a day-to-day basis as that of the national credit reporting system. America has long been called the land of opportunity, and more recently there has been an emphasis on equal opportunity. The national credit reporting system is the tool that ensures that all consumers – irrespective of their age, gender, religion, or ethnicity – are given an equal opportunity to access credit.

I am here today to share some of the preliminary results from research the Institute has recently undertaken designed to quantify the costs and benefits to consumers and the economy from the national credit reporting system, and the potential consequences should Congress decide to allow the Fair Credit Reporting Act's (FCRA's) strengthened preemptive provisions to lapse.

This research is made possible by a grant from the National Chamber Foundation. The NCF is an independent, nonprofit, public policy research organization affiliated with the U.S. Chamber of Commerce -- America's largest business federation. While the NCF is supporting the study, the research program and the analysis are entirely the product of the Institute's own independent efforts.

National Significance of the Credit Reporting System

A good place to begin is with a clear articulation of the importance of this issue. The national credit reporting system's mission is critical to the efficient functioning of the American economy. It should be classified with other vital infrastructure industries, such as the public switched telephone network and the national power grid. Like these other vital industries, consumers frequently take the benefits for granted. They expect their calls to connect every time, and their appliances to always turn on, and, when they qualify, receive credit instantly.

As with the public telephone network and the national electricity grid, the national credit reporting system has a long history and has evolved greatly over time. None of these infrastructure systems are perfect, and all three are prone to occasional errors. Telephone service can be interrupted, power failures do occur, and credit reports sometimes contain inaccuracies. Because of these imperfections, firms in these industries invest hundreds of millions of dollars annually to maintain and improve systems operations to the benefit of the consumer.

Today, just as the great majority of Americans enjoy the benefits of increasingly sophisticated telecommunications and energy distribution technologies, so, too, do most Americans benefit every day from the national consumer credit reporting system that has evolved under the protection of the current federal preemptions. And, when the system breaks down and inaccuracies occur, the law today provides a uniform, understandable, national standard for remediation. One of the key aims of the research we are undertaking is to determine whether it is the uniformity of the system which provides so many of the consumer and economic benefits, and to examine whether these benefits are threatened by the expiration of the preemptions.

The FCRA Progress Report: Greater Access, Lower Prices, Better Quality

As I have already mentioned, the national credit reporting system is not without flaws. However, comparing today's national credit reporting system to some hypothetical notion of a perfect system is neither appropriate nor useful.

What is both necessary and meaningful is a dynamic analysis of the performance of the national credit reporting system -- and its governance structure -- over time. Analysis of the Survey of Consumer Finances, conducted by the Federal Reserve Board, suggests that consumer credit markets have progressed tremendously:

➢ The percentage of families with home-secured debt increased from 35.7% in 1983 to 44.6% in 2001, an increase of over 25%. The percentage of minorities with such debt increased from 21.3% to 35.1%, an increase of 65%.

➢ While increases in home ownership are a function of a variety of factors – prolonged, sustained economic growth during past two decades – preliminary findings from our study indicate that the upswing in home ownership in minority and low income households during the late 1980s and 1990s strongly correlates with the pervasive use of sophisticated risk models and automated underwriting.

➢ In 1983, 60.2% of all households owned a primary residence; by 2001 the total had increased to 67.7%. The largest increases were again observed among the lower income and minority households. Ownership among all minorities increased from 33.9% to 47.1%, an increase of almost 40%.

➢ Expanding access to credit not only increases the opportunity for home ownership, but also provides the opportunity for wealth formation through appreciation and mortgage paydowns. In fact, a recent Federal Reserve Bulletin states that "...the equity that has accumulated in homes is one of the largest components of U.S. household wealth."[1]

➢ Between 1970 and 2001 the overall share of families with credit cards increased from 16 to 73 percent. That's an increase of more than 450% in little more than one generation. This enables more consumers to use credit cards to build a credit record, enables more consumers to smooth out temporary cash flow disruptions using credit, and permits consumers to purchase goods they may want or need today against their future earnings.

➢ Credit accessibility has been extended to groups that were previously not able to obtain inexpensive credit. For households in the lowest income quintile the percent with a credit card increased from 2% in 1970 to 38% in 2001.

➢ Approximately 95% of households in the top income quintile have at least one credit card. Tentative findings from our analysis suggests that because of risk-tiering -- made possible by sophisticated credit modeling -- the gap between the top and bottom has narrowed considerably.

➢ The percentage of minority families with bank-type credit cards has more than doubled over the last 20 years, growing from 26% in 1983 to more than 54% in 2001. Growth was most pronounced among African American families, whose usage grew by 137% during this period. Full-file credit reporting, made possible by the preemptive provisions of the FCRA, enables lenders to distinguish different degrees of risk far better than older, less sophisticated techniques. For instance, if credit bureaus and lenders were forced to rely on Census track data, it is highly likely that many low-risk and better-risk borrowers from minority communities would not be extended the credit they deserve.

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[1] Canner, Glen B., Thomas Durkin, and Charles A. Luckett. "Recent Developments in Home Equity Lending," *Federal Reserve Bulletin*, April, 1998. pg. 241.

- Despite the increased access to credit cards the median balance has remained stable. The FRB Survey of Consumer Finances showed that the median balance was unchanged between 1998 and 2001.[2]

Research Methodology and Assumptions

These findings are highly suggestive on their own of a system and a regulatory environment that functions remarkably well. However, the point of objective research is to unearth the facts behind the facts. That is, what are the key drivers of what appear to be remarkable improvements in the access, growth, and fairness of consumer credit? The Institute is currently undertaking a rigorous quantitative analysis of several possible causes:

- Has automated underwriting contributed to the availability of home mortgage loans and homeownership? Using primary and secondary research, discussed in more depth below, early results from our analysis indicates that the "mass customization" of the mortgage market has played a critical role in the recent increase in the homeownership rates, particularly for segments of the population that were previously underserved.

- Have uniform national standards for credit reporting contributed to a robust consumer credit market? How would the sunset of the preemptive provisions affect the ability of lenders to extend credit to borrowers? Based on an extensive review of recent state legislative proposals, the Institute has created a number of possible post-FCRA sunset scenarios. The Institute is working with credit grantors and credit bureaus to examine the impact of the sunset of the preemptive provisions enacted in 1996 on their ability to model risk, and how this would affect the accessibility and price of credit. The research examines existing state proposals, and models their likely impact on the ability of credit bureaus and financial institutions to model risk based on a sample size of 4.5 million credit files.

- Has the ability to prescreen made consumer credit markets more competitive? How would restrictions on this method of customer acquisition affect the cost and availability of consumer credit? While our results on this component are thus far incomplete, we do have some preliminary findings. Based on responses from 6 of the top 13 bank issuers, prescreening is undoubtedly an important method of customer acquisition. Our preliminary responses suggest that the cost of customer acquisition via prescreening is, on average, less than of other methods of customer acquisition. Moreover, increases in the cost of customer acquisition as a result of restrictions on prescreening, would lead issuers to acquire fewer customers.

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[2] Aizcorbe, Ann etc. "Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances", Federal Reserve Bulletin, January 2003, page 24.

Home Mortgages: Lower Prices, Increased Access and Greater Choice

The cost of a mortgage has dropped significantly over the past 20 years, fueled by intense competition and the growth of the secondary mortgage market. While spreads are affected by broad market forces, relative mortgage rates have, for the most part, trended downward and have remained relatively low even in periods of significant stress—including the collapse of the thrifts in the early 1990s, the international financial crisis of 1998, and the unprecedented refinancing booms of 1992, 1998, and 2002. If spreads today were at their early 1980s levels, the interest rate on a 30 year fixed rate mortgage would be over 7 percent, compared to the 6 percent rate available today. With a total mortgage stock of $5.4 trillion in 2001, **a one percent (100 basis points) savings in the cost of mortgage funds translates into $54 billion in annual savings to consumers.**[3]

The mortgage market is also characterized by a wide array of low-cost products increasingly tailored to the individual borrower's needs. Consumers can now chose among a mix of fixed- and adjustable-rate products which differ with respect to the term of the loan, the frequency of the rate adjustment, and the size of the required down payment. In addition, the industry has created a host of products and programs designed to meet the specific needs of lower income and minority families. This "mass customization" of the mortgage market has undoubtedly played a critical role in the recent increase in the homeownership rate, particularly for segments of the population that were previously underserved.

Uniform National Data Standards and the Safety and Soundness of Consumer Credit Markets

Summarizing his view of federal credit information sharing laws, Federal Reserve Board Chairman Alan Greenspan recently said:

"There is just no question that unless we have some major sophisticated system of credit evaluation continuously updated, we'll have very great difficulty in maintaining the level of consumer credit currently available because clearly without the information that comes from credit bureaus and other sources, lenders would have to impose an additional risk premium – because of the uncertainty – before they make such loans or not make those loans at all."[4]

The question Greenspan's statement begs is whether or not the preemption of state law undertaken in the 1996 amendments to the FCRA have been responsible for maintaining the quality of information available to lenders. As explained above, we are currently

[3] Calculation of mortgage savings: **Step A.** If spreads today were at their early 1980s levels, the interest rate on a 30 year fixed rate mortgage would be over 7 percent, compared to the 6 percent rate available today. **Step B.** The total mortgage stock is $5.4 trillion in 2001. **Step C.** From A., mortgages are 1 percent less expensive. One percent times $5.4 trillion (see B) = $54 billion in annual savings to consumers.

[4] April 30, 2003 report to the Committee on Financial Services by Federal Reserve Chairman Alan Greenspan, in response to a question by Representative Gillmor. Cited from article by Reuters, April 30, 2003. Available at http://www.cardforum.com/html/ccmissue/may02cov1.htm.

conducting a quantitative analysis that seeks to model the effects of FCRA-relevant state proposals on the quality of credit report information. For example, changes to the obsolescence rate of the data contained in credit reports – a component of the Act that currently enjoys federal preemption -- would undoubtedly have an effect on the ability of lenders to model risk.

While we have yet to complete the quantitative component of this portion of our discussion, a survey of state bills is suggestive on its own. During the current legislative session, there have been nearly 250 FCRA-related bills introduced in 46 states.[5] The diversity of these bills – the Institute's own analysis has identified 12 separate categories of such bills – strongly suggests that a post-preemption world will not be characterized by legislative coordination and harmony among the states.

Should the preemptions sunset, one possible near-term result is horizontal preemption – as is likely to occur should a single large state like California enact data restrictions inconsistent with the current FCRA regime. In a very real sense, then, Congress must decide whether it wishes to have its current authority over credit reporting usurped by lawmakers in a single state.

The Relationship between Prescreening and Competitive Credit Markets

In theory, not only do competitive markets offer wide choices of products and service to consumers, but competition in the marketplace also restrains both the prices sellers are able to charge and the profitability of their operations. The data seem to indicate that what is true in theory is also true in practice for both credit cards and mortgages.

For example, in the not so distant past, payment cards nearly all featured the same interest rate (19.8 percent) and yearly fee ($20)[6] and had no ancillary benefits. Likewise, the conventional mortgage market was dominated by 30 year fixed rate mortgages requiring a minimum of 20 percent down. Continuing competition and growing innovation in the marketplace has provided consumers with far more choices today.

While there is not a government-published series showing a price index for credit cards, economists David Evans and Richard Schmalansee have computed one for the period 1984 to 1996.[7] According to their index — which incorporates changes in fees as well as interest rates-- prices declined by almost 35 percent between the first quarter of 1984 and the fourth quarter of 1996. This price decline is particularly significant, given that the

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[5] Data from Information Policy Institute research, in conjunction with Kimbell, Sherman & Ellis. April 2003. Bills included according to criteria for germaneness. Criteria and methodology discussed in forthcoming study by the Information Policy Institute.

[6] "Capital One Financial Corporation," Harvard Business School Case Study 9-700-124, Rev. May 1, 2001, Christopher H. Paige.

[7] David Evans and Richard Schmalansee, Paying with Plastic: The Digital Revolution in Buying and Borrowing, The MIT Press, 1999, p 238-240.

quality of credit cards was also increasing. Evans and Schmalansee attribute these favorable trends to increased competition in the market.
If the index has remained stable since 1997, consumers will have reaped huge savings from this increased competition. With revenues (net of charge-offs) for bank card issuers of $62.6 billion in 2001,[8] **consumer savings from the increased competition would be about $30 billion per year.**[9]

Consumers also enjoy continual increases in the quality of credit cards. Many credit cards today not only provide credit and ease of transactions, but also additional features and benefits, ranging from insurance to purchase protection to rebates and discounts. The Federal Reserve Board collected data on the frequency of such additional features in its most recent survey of the largest credit card issuers.[10] According to this survey, the average card had two or more added features. As shown in Figure 1 below, the most common added feature was travel accident insurance, followed by automobile rental insurance and a reduced introductory rate.

Figure 1: Credit Card Features

DESCRIPTION	COUNT	FREQUENCY OF INSTITUTIONS THAT REPORTED
Rebates on purchases	5	4.5%
Extension of manufacturer's warranty	16	14.5%
Purchase protection/security	17	15.5%
Travel accident insurance	85	77.3%
Travel-related discounts	22	20.0%
Automobile rental insurance	36	32.7%
Non-travel-related goods and services	15	13.6%
Credit card registration	13	11.8%
Reduced introductory interest rate available	33	30.0%
Other, not specified	33	30.0%
Reporting Firms	110	

Finally, not only do payment cards offer additional services, but they have become more convenient to use over the years. For example, a recent advertisement on a United Mileage Plus Visa card noted that the consumer has online access to the account, zero

[8] Calculated from figures in Credit Card Management, A Little Help From UNCLE SAM, James J. Daly,
[9] **Calculation of credit card savings: Step A.** According to Evans and Schmalansee, index prices declined by almost 35 percent between the first quarter of 1984 and the fourth quarter of 1996. **Step B.** If prices have gone down by 35 percent and stayed there, prices are about 65 percent of what they would have been. **Step C.** To return price to the levels of where they would have been, they would increase by 35 percent divided by 65 percent or by 53.8 percent. **Step D.** 53.8 percent of 62.6 billion of revenues (net of charge-offs) is $33.7 billion, which is about $30 billion.
[10] Op. Cit. 2

liability for fraudulent purchases, an option to change the payment due date, and the ability to pay by phone.

These consumer benefits are sizeable and real -- and would be put at risk should Congress fail to reauthorize the strengthened preemptive provision that includes prescreening among the permissible purposes. A number of states, including several large ones, have already proposed to prohibit the dissemination of prescreened firm offers of credit.[11] While well-intended, it is unlikely that these legislators fully understand the causal link between prescreening, competition in the credit card industry, and the full range of consumer benefits described above.

Prescreening Does Not Drive Identity Theft

Undeniably, identity theft is a serious and growing crime. One recent study estimated that the incidence of identity theft has increased from around 50,000 cases per year in 1996 to more than 150,000 in 2002.[12] While most victims generally don't know how their personal information was stolen, the two primary methods reported by the FTC were access through relationship with the victim (52.5%) and lost or stolen wallet (34.4%).[13]

Some seeking to change the FCRA's strengthened preemptive provisions have argued that prescreening is harmful as it affords identity thieves an easy opportunity to fraudulently open a line of credit in another person's name.

Preliminary results from our study offer several reasons why prescreened credit card offers do not drive identity theft. First, prescreened credit card offers do not include the prerequisite personal information needed to commit identity theft.[14] Second, as part of the prescreen process, credit bureaus routinely filter out accounts identified as being at a high risk for fraud. Third, when applying for a card, an individual must provide personal and financial information that must be authenticated by a credit card issuer. Credit card applications, resulting from prescreened solicitations, are not any less rigorous in their requirements that the applicant provide information verifying their identity than other types of credit applications.

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[11] As of the first week of April, 2003 there were proposals pending in 5 states that would restrict the ability of lenders to offer prescreened firm offers of credit. States with such a proposal include California, Connecticut, Massachusetts, New York, and Pennsylvania.
[12] Beckett, Paul and Jathon Sapsford. "As Credit Card Theft Grows, A Tussle Over Paying to Stop It." *The Wall Street* Journal. 1 May 2003. Page 1. Source of data is Celent Communications.
[13] GAO 02-363 at 27-28.
[14] Prescreened offers of credit contain only name and address, which is available on virtually every other piece of mail.

The vast majority of credit card issuers review the application using a variety of sophisticated automated tools. Inconsistencies, such as newly-changed addresses, raise red flags and initiate a barrage of additional questions. **These products are very successful, identifying as much as 80% of fraudulent applications before the accounts are ever opened.**[15]

Finally, prescreened credit card offers simply have a low incidence of fraud. For instance, preliminary data from our survey of credit card issuers indicates that prescreened credit card solicitations are significantly less likely to result in fraud than other forms of new account acquisition.[16] In some cases, this number is substantially higher. While prescreened credit card offers are unproblematic, we do believe that credit card applications through the Internet – which are routinely between 2 and 5 times more likely to result in fraud than accounts acquired through other media – deserve further scrutiny. It makes some sense that the incidence of identity theft and fraud are higher on the Internet, as identity thieves are more likely to utilize the most anonymous medium. Further, unlike prescreened firm offers of credit through the mail, which are almost always checked against fraud databases, applicants on the Internet are self-selected, so there is no preliminary fraud screen.

Ultimately, however, should Congress permit the preemptive provision on prescreening to expire, and states, in turn, move to prohibit prescreened credit card offers, issuers will have to reach consumers through other, riskier channels. Oddly, a ban on prescreening would likely result in an increase in fraud and identity theft – precisely the opposite of the intended effect.

Consumer Credit Helps Finance Small and New Businesses

Credit cards represent an important source of financing for small businesses. In 1998 about 45 percent of all small businesses (defined as those with fewer than 500 employees) used personal credit cards as a financing source.[17] Among these small businesses, firms with a smaller number of employees and smaller sales, have a higher prevalence of personal credit card use. Credit cards are even more important sources of financing for those firms that have been rejected for other sources of financing. Among those who had sometimes or always been denied loans, 65 percent used their personal cards to finance their business, while among those who had not been denied, only 45 percent uses their personal credit cards.[18]

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[15] Preliminary finding based upon April 2003 survey of major financial institutions and credit reporting agencies. Final figures will be included in forthcoming study by Information Policy Institute.
[16] Op. Cit.
[17] Financial Services Used by Small Business: Evidence from the 1998 Survey of Small Business Finances, Marianne P. Bitler, Alicia M. Robb, and John D. Wolken, Federal Reserve Bulletin, April 2001, p 192.
[18] Calculated from data in the 1998 Survey of Small Business Finances

Consumers Generally Satisfied with Current System

Whether consumers are satisfied with the widening access to credit is of course a complicated matter. Certainly, if behavior reveals preferences, consumers want access to greater credit and do in fact acquire more credit when approved and offered. The answer is in many ways a plural one made so by the fact that the extension of credit comprises vast areas of consumption, from homes and education to travel, restaurants and books, by wider segments of the population for a diversity of purposes. Homeownership certainly seems to meet the aspirations of many households. And it is unlikely that historically underserved populations who now have greater access to the possibility of owning a home would want a return to the earlier credit regime.

However, surveys of credit card users paint a mixed picture. Majorities of consumers simultaneously believe that credit card companies make too much credit available[19], that overspending is the fault of the consumer[20], and yet also are satisfied in their dealings with credit card issuers, believing that they provide a useful service[21]. What has changed significantly is the satisfaction that consumers have in their dealings with credit card companies; whereas a majority report being satisfied in 2000, in 1977 only 17% did so.[22] Reduction of access to credit as a means to prevent overextension by borrowers, of course, risks reorienting policy towards the paternalistic. But the fear of general overextension appears, if the survey results are right, to be a fear of the other peoples' credit habits as opposed to self-evaluation for the majority of credit card users.

National Credit Reporting System Not Perfect, But Works Very Well

If I can leave you with one takeaway point, it is that the national credit reporting system that has crystallized under the FCRA, works exceedingly well. The consumer and economic benefits, as I have briefly documented in this testimony and as our forthcoming research will quantitatively demonstrate, are pervasive and substantial.

The national credit reporting system, as with the public telephone network and the national power grid, is an essential facility to the American economic infrastructure. None of these systems are perfect, yet all play a vital role in the day-to-day economic behavior of millions of consumers. New regulations have never prevented power outages or disruptions in phone service, nor are they likely to solve the systems maintenance issues in the national credit reporting system.

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[19] Durkin reports that 68% 'strongly agree' and 20% 'agree somewhat' with the statement "Credit card companies make too much credit available to most people". Thomas Durkin, . p. 629

[20] Durkin reports that 63% 'strongly agree' and 27% 'agree somewhat' with the statement "Overspending is the fault of consumers, not the credit card companies".

[21] Durkin reports that 51% 'strongly agree' and 40% 'agree somewhat' with the statement "I am generally satisfied with my dealings with the credit card company." 44% 'strongly agree' and 48% 'agree somewhat' with the statement that "Credit card companies provide a useful service to consumers."

[22] That is, only 17% strongly agreed with the statement that they were satisfied in their dealing with credit card companies.

Given the vital economic role played by the national credit reporting system, the ubiquitous economic and consumer benefits evidenced by data from the past 30 years, and the overwhelming consumer satisfaction with the current system, we strongly encourage Congress to make permanent the preemptive provision of the FCRA.

By taking this step, Congress is ensuring that all Americans -- regardless of their age, income, ethnicity, and gender – are given equal access to the opportunities that access to credit provides.

Written Statement of Michael S. Uffner
President, Chairman and CEO
AutoTeam Delaware
On behalf of the U.S. Chamber of Commerce
Before the Subcommittee on Financial Institutions and Consumer Credit
House Committee on Financial Services
United States House of Representatives
Hearing on "The Importance of the National Credit Reporting System to Consumers and the U.S. Economy"

May 8, 2003

Good morning Mr. Chairman and distinguished members of the Subcommittee. Thank you for inviting me to testify before you today. I commend you for your efforts to protect the nation's economy and for holding a hearing on this important issue.
My name is Michael Uffner and I am the President, Chairman and CEO of AutoTeam Delaware, a regional automobile dealer, located in Wilmington, Delaware, with customers throughout the region, including Delaware, Maryland, New Jersey and Pennsylvania.

I am here to speak with you today on behalf of the U.S. Chamber of Commerce. I became a Member of the Board of Directors of the Chamber of Commerce in 1998. I also serve as Chairman of the Chamber's Public Affairs Committee, and am active in the Delaware State Chamber of Commerce, where I formerly served as State Chairman.

The Chamber is the world's largest business federation, representing more than three million businesses and organizations of every size and in every industry sector and region of the country.

Introduction:

A Failure to Reauthorize the Fair Credit Reporting Act (FCRA) Could Cause Major Disruptions In Everyday Business Operations.

As a preliminary matter, I wanted to discuss the breadth of interest and concern that surrounds this important issue, and why the U.S. Chamber, as a broad-based business association, is so engaged. The reason is simple: a failure to reauthorize the FCRA could adversely affect almost every industry sector in the economy. For example, as Members of the Financial Services Committee, you are doubtlessly aware of the severe disruptions that a multiplicity of credit rules across multiple states could wreak on the credit industry and their customers, making it more difficult and expensive for consumers to obtain credit for everything from home and car loans to student loans and credit cards.

However, a failure to reauthorize the uniform standards of the FCRA could also cause significant problems throughout the economy, from manufacturing and technology to everyday services that people simply take for granted, like utility service and shopping.

While my experience may be typical for an auto dealer or a small retailer, these issues cut across the business spectrum. For your convenience, therefore, I am including as an appendix to my testimony a short description of how a wide range of industries relies on the smooth and continued operation of the FCRA.

What is the Fair Credit Reporting Act?

The Fair Credit Reporting Act (FCRA) is the statute that generally governs the use of credit information: payment history, amount of available credit and debt, etc., but NOT information about a person's income. It puts very strict limitations on how credit information can be used, and how consumers can dispute information that they believe is wrong.

The FCRA has been instrumental in helping to create the national credit system that we enjoy today, helping to facilitate the creation of our whole consumer credit economy, from the miracle of instant credit to the ubiquitous availability of credit cards.

As you may know, prior to 1970, credit was generally very localized -- dozens of credit bureaus operated in different parts of the country, and, because little credit information was shared, it was often difficult for people who moved to obtain credit beyond their local area. Further, it was often difficult for consumers to obtain credit -- consumers could obtain retail credit cards, and could get credit from their bank, but there was little widespread availability or competition. Today's consumers enjoy more competition and convenience because consumers who were formerly forced to obtain their car loans and home financing from their bank can now get the most convenient and best deals from their auto dealer, their realtor, or a bank across the country.

For example, before the modern FCRA, it was difficult to directly finance purchases for our customers. In fact, customers often had to shop around to a couple of different banks, wait a few days for approval, and compare financing packages that way. Now, they can obtain instant financing through us, through their own bank, or even through companies that may not even have offices in their state!

In 1996, Congress updated the FCRA in two very important ways: first, it strengthened the protections enjoyed by consumers, and second, it recognized the critical importance of a national, uniform credit reporting system. Congress changed the law so that a number of specific sections of the law could not be regulated by the states and, in so doing, established a national, uniform credit reporting system. However, Congress limited the operation of the national system by providing that the parts of the legislation that preempts the states would expire after 7 years -- on December 31, 2003. Therefore, at the end of the year, the states will be free to implement their own changes to the FCRA, potentially creating a patchwork of different rules and obligations.

As others with more knowledge and expertise than me can testify, such a patchwork could wreak havoc on the nation's credit system, making credit reports much less reliable, and increasing the cost and time and hassle required to obtain credit, therefore reducing credit availability. The customer benefits from these efficiencies, and the customer will be the one to pay the price for the lack of uniformity

<u>The Case for Uniform, National Standards</u>

Because I come from the great State of Delaware, which, incidentally, the U.S. Chamber recently rated as having the best state legal system in the country, I am not particularly worried about any ill - considered rules that my state legislature might impose on small businesses or on the credit reporting system. However, my ability to conduct my business could be directly impacted if other states enact their own rules, even if I do not have any business relationships with those states.

First, if states were to enact different credit rating or reliability standards, consumers in one state might be placed at a competitive disadvantage. Like many companies of all sizes, I generally operate on a regional basis, and have customers from four states, as well as occasional customers from states as far away as West Virginia and even Texas. For companies like ours who operate on a regional basis and serve customers from multiple states, a uniform national standard is vital. If there are different credit rating and reliability standards for customers from different states, that may affect my ability to serve customers from those states, and may force me to charge different prices for customers based solely upon where they live. I have lots of loyal customers, and neither they nor I would want to see a state law that forced me to charge them a higher price or reduce the services that I can provide to them.

Second, if a state enacts a law that reduces the information available on a credit report, making it less reliable, that means that my customers from that state may have to pay higher rates to compensate lenders for increased risk. Or, if a customer moves to Delaware from a more restrictive state, my lenders may be forced to undertake an expensive investigation of my customer's credit history to compare it to Delaware's – such an invasive process surely would not "protect" consumers in those other states. Additionally, customers may face higher interest rates, and a whole chunk of lenders from outside the state may be precluded from making loans to customers from particular states.

Finally, credit furnishers, companies that *voluntarily* provide information to the credit bureaus every month detailing customers' payment history, are legitimately concerned about increased liability for mistakes made in reporting payment history to the credit bureaus. For example, even with good employees and strong procedures in place to minimize any mistakes in reporting payment history to a credit bureau, mistakes do occasionally occur. When they do, the FCRA requires that furnishers and credit bureaus do a quick and thorough check to ensure accuracy. However, if the rules were changed so that even when innocent mistakes are made and promptly corrected companies could still be found strictly liable for any damages, many companies would consider ceasing to provide that information to the credit bureaus. If risk managers began advising credit furnishers to cease providing information voluntarily, the entire credit reporting system could be impaired. For example, if all auto dealers stopped reporting credit information, a lack of credit and payment history could severely hurt the ability of low-income households to establish credit. If a consumer's only loan is a car loan, but their stellar repayment history is not reported to the credit bureaus, they may lose the opportunity to move from the sub-prime market to the prime lending market – all because too much potential liability scared the voluntary credit furnisher out of the reporting business.

In a national economy that depends on interstate commerce and allows consumers and businesses easy access to services in other states, a national, uniform standard that treats every customer the same is vital. Dismantling our national consumer credit system will weaken the country's' credit reporting and credit availability systems, and could take consumers back to the days of inconsistent reporting, error-riddled credit reports, higher credit costs, more paperwork, time-consuming credit application procedures and less choice in the retail marketplace, thus putting increased strain on our economy and reducing transaction efficiency.

In addition to the concerns I've outlined above, I'm also concerned about the ability of companies, like mine, to continue sharing certain information across their corporate structures. The ability to share information across affiliates is vital to many businesses because it permeates their whole ability to care for their customers.

In some cases, auto dealers and others may have corporate structures made up of many separate but affiliated firms linked by common ownership and control but perceived, correctly by their customers, as a single brand. Currently, under FCRA, members of the same corporate family can share with one another information about their transactions and experiences with consumers. FCRA also allows affiliates to share certain other types of information if the consumer is first provided a notice and an opportunity to opt out of such sharing. If the ability to share information amongst affiliates is significantly curtailed by state action following the expiration of FCRA's current provisions, the ability to serve customers could be adversely affected.

Restrictions on information sharing could turn a series of transactions that are seamless to the customer into time-consuming, multiple transactions. This could not only add to the hassle and stress of customers, but could increase the potential for errors, could cause consumers to miss or forgo potentially vital services. Further, multiple transactions could actually increase the opportunities for identity theft if, for example, the number of people handling a single transaction increased from one to many.

This is also true of business, and particularly small business – many entrepreneurs take out loans or borrow from their credit card to start a company or sustain themselves during lean times. If it is more difficult and expensive to obtain critical financing, many small business owners may decide that the costs are too great. Small businesses and consumers have been the drivers in this weakened economy – don't shut them down, now that the economy is just getting its legs back.

While it is beyond the scope of my testimony today, I would also like to note that the Chamber is concerned by the application of the FCRA to employment investigations (for example, the Federal Trade Commission's so-called Vail letter) and non-credit related employment background checks. Interpretations of the FCRA have made it more difficult for employers to effectively investigate allegations of workplace misconduct and carry out their responsibility to provide a safe and secure work environment. The Chamber would be happy to work with the Committee to address these important issues.

Conclusion: The FCRA protects Consumers, Businesses and the Economy

The current Fair Credit Reporting Act helps me to meet the needs of my customers. If a customer needs financing at 8:30 at night, the current system provides me with the tools to complete the transaction in a highly competitive and efficient market. What would happen to consumers and the consumer economy if every company like mine had these potential problems: if retailers couldn't provide seamless service to their customers; if banks and lenders had to impose significant delays or burdens on their customers ability to borrow money; if sub-prime lenders stopped reporting payment history to the credit bureaus; and if companies that operate across state lines had to charge different customers different amounts.

The concerns regarding what could happen to my company if parts of the FCRA become subject to multiple state rules is simply a microscopic look at the huge implications that a failure to reauthorize could have on the entire economy. The economic displacement throughout the economy would be massive. We would not only see more hassle, cost and headache for consumers, but would also see a significant drop in the amount of borrowing and therefore spending, that a customer might do. In an economy 2/3rds driven by consumers and consumer spending, that would quickly translate into a huge hole in the economy.

If Congress allows these amendments to expire, the benefits of our national consumer credit system that have evolved over the last seven years will likely unravel. This potential patchwork of dozens of divergent laws and systems could result in significant detrimental consequences for consumers and businesses.

Again, thank you very much for the opportunity to present my experience to this Committee. I would be happy to answer any questions.

Appendix:

Who Has a Stake in FCRA Reauthorization?

Banks and Credit Unions – Banks rely heavily on accurate credit reports to assess banking and lending risk, manage portfolios, detect fraud, acquire new customers and grow those relationships.

Credit Card Companies –There are about 40,000 different credit card products available to fit the needs of almost every U.S. consumer, including low interest rate cards, mileage cards, cash back cards, etc. Nearly 185 million people have credit cards, and they charged $1.3 trillion in purchases in 2001. Credit card companies utilize information from consumer reporting agencies to identify potential new customers, minimize lending risk, prevent fraud, manage customer portfolios and improve customer relationships and experiences. Loss of information would make it more difficult to obtain and retain customers and would result in increased losses to fraud and delinquency, and reduced availability of credit through credit cards, which would fall disproportionately on the low end of the economic scale.

Securities Industry – It is critical to business that they have the ability accurately analyze the financial status and capacity of potential investors, and information from consumer reporting agencies is a critical component.

Mortgage Brokers and Bankers – Home sales are expected to top 6.5 million units this year, in addition to millions of refinancing applications. Mortgage brokers and bankers processing the applications and making the loans must be certain that consumers obtain the best possible terms, and that the loans are sound and that the loans meet secondary mortgage market requirements.

Real Estate Secondary Market – Freddie Mac estimates that single-family housing mortgage originations will exceed $2 trillion in 2002. Information from consumer reporting agencies is critical to ensuring the loans they buy are sound. Freddie Mac's automated underwriting platforms depend on information from consumer reporting agencies in order to facilitate the securitization of real estate mortgages.

Insurance Industry – In 1999, the insurance industry paid out more than $24 billion in fraudulent property and casualty claims. Information from consumer reporting agencies has proven to be a very valuable tool for not only helping prevent insurance fraud, but also for accurately predicting who will pay premiums on time and the likelihood that a person will make claims.

Automobile Dealers – Auto dealers play a vital role in the automobile financing environment by making temporary loans that are sold within a few days to financial institutions. Auto dealers rely heavily on consumer reporting agencies to make risk decisions on "instant loans."

Retailers –Information from FCRA-regulated databases makes instant credit and instant check-cashing privileges possible. Without information from consumer reporting agencies, the application and approval processes for larger purchases would be longer, far more complex and would result in fewer approvals.

Internet Companies – Fraud is a tremendous concern for Internet companies. Information from consumer reporting databases helps them prevent fraud by verifying or authenticating the identities of their customers. In addition, online transactions are almost always credit based. Without information from consumer reporting agencies, online business transactions would be nearly impossible.

Computer and Technology Manufacturers – Major computer manufacturers like Dell, Gateway, IBM, Hewlett Packard and Sony have established credit operations to finance the purchase of consumer electronics, such as personal computers. Information from consumer reporting agencies helps them make sound credit decisions, prevent fraud and provide quality customer service.

Employers – Employers today must consider more than whether a person's resume indicates they are qualified for a job. Security, fraud and theft are also very important concerns. Information from consumer reporting agencies is increasingly valuable for verifying a person's identity, application fraud and, particularly with regard to financial and accounting positions, indicators of financial risk.

Multifamily Housing (Tenant Screening) – Apartment and condominium managers need to know not only that prospective tenants will pay their rent on time, but also that the application information they provide is true. Information from consumer reporting agencies makes it possible to verify the financial capability of the applicant, as well as to verify the identity of the applicant and the information provided in the application, reducing the occurrence of application fraud.

Wireless Telecommunications – The most difficult part of obtaining cellular telephone service usually is picking the model of telephone and accessories you want. That is only possible because of information from consumer reporting agencies that enable service providers to instantly evaluate at the point of sale the risk that a consumer will not pay bills as agreed, to validate the content of an application and verify the identity of the applicant.

Utilities – Americans register more than 40 million changes of address each year with the U.S. Postal Service. With each move, the new resident must establish a relationship with new utility providers. Utility companies depend on information from consumer reporting agencies to verify a new customer's identity, assess risk of non-payment and to help establish appropriate security deposits or other service charges to mitigate losses due to non-payment.

Child Welfare Enforcement Agencies – Consumer reports are a valuable tool for enforcing child support payment, because missed payments can be included on a credit report, increasing the spouse's opportunity to obtain payments. And when a parent with past due child support payments disappears, information from consumer reporting agencies can be instrumental in locating the parent and enforcing the law.

Law Enforcement Agencies – Information from consumer reporting agencies is a critical component of law enforcement efforts. Traditionally, the information has been critical for locating crime suspects and potential witnesses, identifying suspects or verifying their identities and assisting in investigations. Today, that information is even more critical for law enforcement for preventing acts of terrorism.

Check cashing services – During 2001, checks were written for a total of almost $50 trillion. Of the checks written, nearly 1.2 million a day were bad. Check cashing services, which are entities regulated under FCRA, help prevent fraud and ensure merchants that the checks they cash won't bounce.

Other businesses -- Information from consumer reporting agencies is playing an increasingly important role in not only making financial decisions, but also in preventing fraud and ensuring the safety and security of our children and families. For example, consumer reporting agency information is a valuable component of background checks for teachers, bus drives, day care center operators and others.

Consumer Federation of America

Credit Score Accuracy and Implications for Consumers
December 17, 2002

Consumer Federation of America
National Credit Reporting Association

Table of Contents

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 consumers[1]. 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 rising[2].

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 percent[3]. 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

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[1] Klein, Daniel. 2001. Credit Information Reporting. Why Free Speech is Vital to Social Accountabilily 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 overrides[4].

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.

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[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 Group[5] 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 survey[6] 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 survey[7] 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 Andersen[8], 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

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[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 report[10]. 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 (Cclorado, 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

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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 score[11]. 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 decision[12].

[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 test[13].

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[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.

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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 reports[15]. 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 Countrywide[16].

[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, 2002[17].

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

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[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 such[18]. 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 West[19], 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.

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[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
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
159	Subtotal: number of files excluded from analysis
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 data[20]. 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 regions[21].

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.

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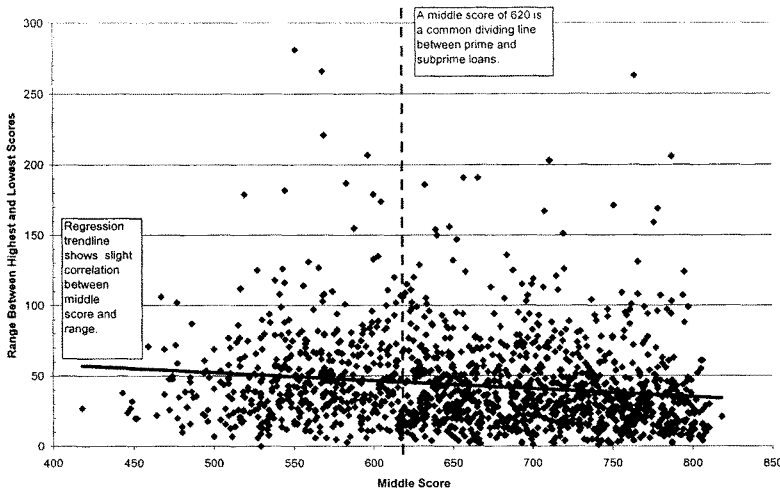
[20] Fair Isaac, and Company address the question of differing information at the three repositories as part of the explanation of how credit scoring works on their consumer oriented website, myFICO.com, stating: "Your score may be different at each of the three main credit reporting agencies: The FICO 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.

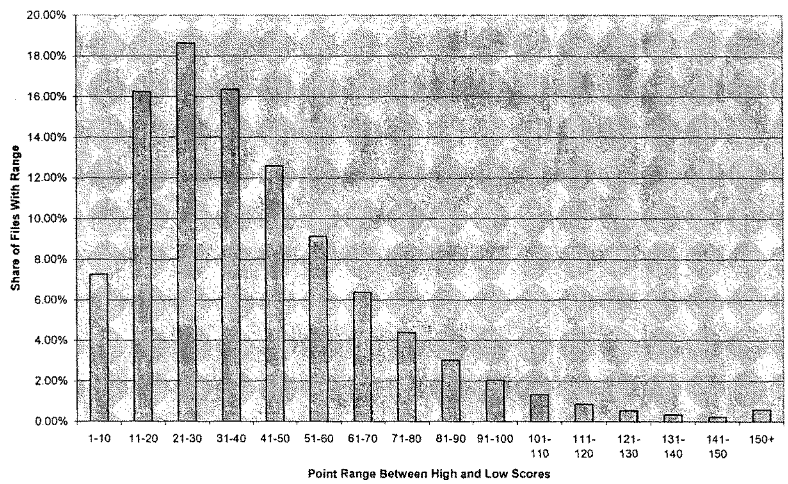
1. Scores Reported by the Three Repositories for a Given Consumer Varied Substantially.

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 96[23]."

The use ot 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 marketplace[24]. 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).

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[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

		Omission		Commission			
Type of Account	Status	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 office[25]. 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 obscure consumers' credit has drawn repeated condemnation from John Hawke, the Comptroller of the Currency[26]. 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 the 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 for[27] 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 mortgage[28], 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 payments[29].

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 posses 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 models[30], 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 soon[31]. 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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May 5, 2003

The Honorable Herb J. Wesson, Jr.
65th Speaker of the California State Assembly
State Capitol
Sacramento, California 95814

RE: CALIFORNIA SENATE BILL 1

Dear Speaker Wesson,

I am writing this letter as a concerned businessman and citizen of this great state of California. It has come to my attention that there are legislative issues currently being discussed that could have detrimental effects on the Latino community reaching economic success.

Economic success can only come about when opportunities are available to all people on an equal basis. Having access to consumer credit is one of those opportunities. Economic advances come only with a credit system that helps companies know about their customers and understand their needs. Even with basic information that is lacking, an individual coming into the credit market, people like new homebuyers or those starting small businesses, risk not having the benefits and opportunities long afforded to others.

The idea of not knowing anything about an individual hinders the ability of many companies to give that individual what they have earned or to offer opportunities previously available to only a select few. Restricting information can cause incomplete or misleading information to be sent to thousands of businesses, insurers, banks, employers, and others that make everyday decisions on the eligibility of an individual to establish credit or to obtain loans.

In the long run, advocating that information about an individual should not even be shared within a specific company would result in a direct and immediate impact on the quality and availability of credit and products for the Latino community as well as other traditionally underserved markets in California.

Latinos have made great strides in our society and have helped in bringing about social and economic growth in our great state. I would urge you to take this fact into consideration when you are contemplating legislative issues such as Senate Bill 1, that have a very real potential of hurting the efforts of Latinos and many others struggling to achieve the American dream.

Sincerely,

David C. Lizárraga
President & CEO

cc: California Latino Caucus
President Pro Tempore of the California State Senate
California Attorney General
U.S. Hispanic Chamber of Commerce
California Hispanic Chamber of Commerce
Governor of California
Lt. Governor of California

Hearing of Financial Institutions and Consumer Credit Subcommittee on "The Importance of a National Credit Reporting System to Consumers and the U.S. Economy"

Question for Assistant Secretary Wayne Abernathy from Congressman Patrick J. Tiberi:

Section 507 of the Gramm-Leach-Bliley Act appears to authorize states to enact privacy laws that are more stringent than the Gramm-Leach-Bliley standard. Section 506(c) of the Gramm-Leach-Bliley Act also makes clear that the Gramm-Leach-Bliley Act in no way modifies or supersedes the Fair Credit Reporting Act and that Act's preemptions of state law. What is your reading of the interaction of Gramm-Leach-Bliley and the Fair Credit Reporting Act with regard to state laws on affiliate-sharing?

Response:

The interaction of the Gramm-Leach-Bliley Act (GLBA) and the Fair Credit Reporting Act (FCRA) is to prevent states (except Vermont) from restricting the sharing of information by financial institutions with affiliates until January 1, 2004. Although section 507 of GLBA permits states to enact laws that may provide greater protection than under Title V of GLBA, GLBA also clearly states that it does not modify, limit or supersede the operation of the FCRA. Thus, GLBA does not override section 624 of the FCRA, which prohibits any state (except Vermont) from restricting the sharing of information among affiliates until January 1, 2004.

This matter was the subject of a colloquy between Senate Banking Committee Chairman Phil Gramm and Senator Connie Mack on November 4, 1999 (*Congressional Record*, S13901). Senator Mack asked to confirm that "section 507 is intended to apply only to the amendments made by subtitle A of title V of the bill, and that section 507 is not to be construed, under any circumstances, to apply to any provision of law other than the provisions of subtitle A." He continued: "This means that section 507 of the bill does not supersede, alter, or affect laws on the disclosure of information among affiliated entities. In particular, section 507 does not supersede, alter, or affect the provisions of the Federal Fair Credit Reporting Act (or FCRA) regarding the communication of information among persons related by common ownership or affiliated by corporate control, nor does section 507 supersede, alter, or affect the existing FCRA preemption of state laws with respect to the exchange of information among affiliated entities."

Senator Gramm responded, "the understanding of the Senator from Florida is correct." He explained: "Section 507 is intended to apply only to subtitle A of title V of the bill, and is not to be construed to apply to any provision of law other than the provisions of the subtitle. Thus, section 507 does not affect the existing FCRA provisions on that statute's relationship to state laws."

Responses of Dean E. Sheaffer
SVP – Credit and CRM
Boscov's Department Store, LLC
On behalf of the National Retail Federation

To

Questions of the Honorable Rube'n Hinojosa
House Financial Services Committee
Subcommittee on Financial Institutions
"The Importance of the National Credit Reporting System"
to Consumers and the U.S. Economy
May 8, 2003

QUESTIONS FOR SCHAEFFER (sic)

Question (1) – Am I correct that participation in the national credit system and reporting to agencies is completely voluntary? If so, Do you think failure to reauthorize the FCRA would impact reporting and, therefore, accuracy and reliability of the system? What would this mean for consumers?

Answer – Participation in the national credit reporting system is completely voluntary. Failure to reauthorize the FCRA would allow states to set as many as 50 different standards for the type and format of information reported; the timing of reporting certain delinquency information; the retention of information; and creditor liability.

Compliance with multiple states' standards would cause all creditors to expend significant capital and human resources. In addition, creditors such as Boscov's would be forced to make a business decision whether or not to report credit information for customers on a state-by-state basis. It is highly probable, based on proposed state legislation, that Boscov's would elect not to report information on customers residing in certain states.

The result of Boscov's and other creditors' electing not to report information on consumers is really very straightforward. Credit Scores (FICO and others) are based on available credit information contained in a consumer's credit report. Should the available information be diminished, the ability of credit scores used to predict risk and other consumer behaviors would be comparably diminished.

In order to maintain a consistent margin on their loan portfolios, creditors would be forced to either reduce the number/amount of loans underwritten or to increase the consumer's cost of the loan, as they would have a less predictive set of scores on which to make credit decisions. In either case consumers on the margin (those most in need of credit) would be the losers in the equation.

Question(2) – How would failure to reauthorize the FCRA specifically impact Boscov's and it's customers?

Answer – Many of the impacts of a failure to reauthorized the FCRA are addressed in my written testimony. I summarize the specific impacts to Boscovs' below.

The permanent reauthorization of the seven areas of state law preemption contained in Section 624 of the Fair Credit Reporting Act or FCRA is critical. These preemptions govern: ***Reinvestigation Timeframes*** (the time by which a credit bureau must take any action in any procedure related to the disputed accuracy of information in a consumer's file); ***Adverse Action Responsibilities*** (the duties entities have when taking "adverse action" against a consumer on the basis of information contained in a credit report or on information obtained from third parties other than credit bureaus); ***Prescreening*** (the process of selecting consumers for "preapproved" offers, and the duties imposed on those entities engaging in prescreening); ***Information Contained in***

Credit Reports (including obsolete information and information regarding delinquencies); ***Furnisher Responsibilities*** (the obligations and potential legal liability imposed on those entities that report raw data to credit bureaus); ***Consumer Disclosures*** (the form and content of certain disclosures which must be provided by a credit bureau to a consumer); and ***Affiliate Sharing*** (the exchange of information among affiliated entities, regardless of whether such information is a credit report or credit related).

The uniform standards adopted in 1996 have coalesced nicely with emerging computer technology to create the most fair and efficient credit reporting and credit granting system in the history of our country. Sophisticated models have allowed creditors to more accurately assess risk and have allowed for the introduction of innovative products and lower APRs.

Furnisher Responsibility

Uniform standards on furnisher obligations are critical to the integrity and overall success of the current voluntary reporting system. In an age where trial lawyers loom at every turn, the limits on furnisher liability help keep credit granters in the reporting system. Inconsistent or heightened liability standards and the creation of new private rights of action would ultimately discourage lenders from supplying information – particularly negative information – out of fear of being sued. Like the system established by the merchant's associations of old, credit reports are only as good as the information going in. If a potential creditor does not have a complete view of the consumer's information because other creditors are withholding information the risk-assessment may not be adequate. This perceived increased risk would have to be factored into the loan, driving up the cost of credit and diminishing credit availability in those communities. Reinvestigation Time Frames.

Thus the specific impact to Boscov's and our customers would be the reduction in either the number or amount of loans underwritten and/or an increase in the consumer cost of the loan.

Some of the largest retailers report on over seventy-five million customers per month to the three national credit bureaus. Remarkably, the reported error rate is well under one half of one percent (.05). Oftentimes, these errors are simply mismatches of information to credit bureau files and never impact a consumer's report. Examples of these types of mismatches are minor variances in a customer' name, address or date of birth. Further, significant errors that inadvertently make it on to reports are corrected quickly at the consumer's request, often in much less time than the thirty days required under the FCRA. The usual time to handle a dispute at Boscov's is about fourteen days; however the full thirty days may be needed to resolve more complex disputes.

Again, the national uniformity established in 1996 helps make this efficient system possible. If states were allowed to act independently to shorten these periods to twenty, fifteen or even ten days, consumers would necessarily be treated differently by furnishers based simply on their state of residence. Disputes in a thirty-day state would always be bumped back the minute a complaint came in from a consumer in a ten-day state. Imagine the frustration for customers as well as the complication for merchants who operate in multiple states.

Boscov's operates in five Mid-Atlantic States. For us, this could mean having five separate dispute resolution procedures in place. For the largest retailers it could mean having fifty different procedures in place.

The specific impact to Boscov's and our customers would be a non-uniform approach to dispute resolution, likely resulting in slow responses to critical disputes in favor of accelerated state mandated responses to nuisance disputes.

Prescreening

Another important preemption under the FCRA is that for prescreening. Retailers like Boscov's use prescreening to grow our customer base. This isn't just important to our credit card business. We use this same customer base as the best predictor of where to open a new store. With a typical store size of 200,000 square feet, we operate almost exclusively as an anchor store in regional Malls. For us, it takes as many as ten to twenty thousand known customers to venture into a new location. Boscov's is still growing. We open an average of two to three stores per year. Last month, we opened our newest store in Westminster, Maryland and in the fall we will open another in Frederick. Over the past few years we have opened one or more stores in every state in which we do business.

The specific impact to Boscov's and our customer is that if any Mid-Atlantic state were to act to prohibit prescreening, it would undoubtedly slow down Boscov's stores entry in to new markets in that state.

Affiliate Sharing

A Boscov's department store is considered to be a reliable place for one-stop shopping by our customers, but, in fact, it is really a web of affiliated companies and third-party licensees providing exceptional services under the Boscov's company name. This complex business structure is necessary for many legal and accounting reasons, however the structure is completely transparent to our customers. What they get is the great customer service that has kept them shopping with us for years.

This is all made possible by information sharing in the retail environment. Through information sharing we can not only market more specifically to our customers and meet their needs, but we can also do other things such as underwrite more credit and combat identity theft in our stores.

Retailers use the data and transaction histories that they collect from their stores and affiliates to create internal credit scores and models that help determine a consumer's eligibility for credit. This information supplements credit reports and FICO scores to paint the most accurate picture possible of a customer. In fact, retailers most often use this type of information to grant credit to people on the margins and those who are just entering the credit market.

For instance, if someone comes in to a retail store needing a new refrigerator or washer/dryer, they often apply for "instant" credit to complete the purchase. When the retailer pulls their credit report they may see a lower-than average FICO score or information indicating a bankruptcy five years ago. These are often reasons to deny credit, but, by using their own internal models that predict the credit habits of similarly-situated customers, the retailer may be able to draw the conclusion that the current customer is not, in fact, a credit risk. Again, this type of information sharing helps retailers determine risk and underwrite credit, allowing people at the margins in lower to middle income households with mediocre FICO scores obtain credit when they most need it.

The specific impact to Boscov's and our customers would be a diminished ability to grant credit cost effectively and a diminished ability to recognize, prevent, pursue and prosecute Identity Thieves.

QUESTIONS FOR All WITNESSES ON PANEL II

Question – How fair is the current system of consumer credit reporting? Is there evidence to suggest that any demographic segments have been subject to exclusion, predation, excessive costs or other indictors of bias as a result of the pervasive use of credit scores and automated underwriting by consumer credit lenders?

Answer – I believe the current consumer credit reporting system to be the fairest in existence. For example, Boscov's reports monthly information on all active accounts to the three major Credit Reporting Agencies in the U.S. The reporting is based on the same criteria and contains the same data set for all customers regardless of demographic segment. Rather than leading to exclusion, predation, increased costs or other biases, the system leads to exactly the opposite; a "leveling of the playing field" for all consumers regardless of demographic segment.

The credit system is built upon the fundamental knowledge that historical credit behavior is predictive of future credit behavior. Tremendously complex scoring systems and neural networks are built upon this knowledge and are constantly fine tuned to ensure that best "discrimination" between those customers who will pay and those who won't is made. Such modeling systems and neural networks do NOT rely upon demographic segmentation, but rather rely upon this historical credit usage and payment patterns for an individual consumer.

Question – Is there evidence that explains the major sources and causes of identity theft?

Answer – It is my belief that the major contributing factor to identity theft is the ease with which one can obtain "real" state and federal I.D.s using fictitious, false or stolen documents. The availability of equipment to manufacture state drivers' licenses further exacerbates the problem.

Retailers make every effort to prevent bad actors from using false identification as a means to obtain credit. However, I recently testified in Pennsylvania on a panel with Philadelphia District Attorney Lynne Abrahams. Ms. Abrahams indicated in her testimony that in reviewing fraudulent PA drivers' licenses, she once stood in front of a "wall" of Pennsylvania licenses and could not discern the real licenses from the fakes.

If it is the case that law enforcement is unable to discern the validity of customer identification, it is impractical to expect retail clerk to be able to do so. Requiring states to "lock down" the process of issuing and controlling drivers' licenses; including anti-counterfeiting features in the licenses; and providing a mechanism to ensure that the holder of the identification is the identified individual would significantly reduce the incidence of identity theft.

Question – Does this evidence point to the consumer credit information system? Do you have any data suggesting that prescreening is a major factor of ID theft? What about the point that the FCRA and the smooth flow of information sharing it provides, helps financial institutions prevent and combat identity theft?

Answer – The evidence above does not point to the consumer credit information system. We have no data suggesting that prescreening is a major factor of ID theft. In my written testimony, I argued strongly that the smooth flow of information sharing helps prevent and combat identity theft. I have summarized the testimony below.

Retailers use information to fight identity theft. As you know, identity theft is one of the fastest growing and most troublesome crimes in the United States. At Boscov's we have implemented a number of safeguards to help protect our business and our customers. As you will see, many of these procedures rely directly on the sharing of information.

When a customer applies for the Boscov's charge card in one of our stores, they must present a current, valid, state or federally issued picture I.D. (such as a driver's license or passport). When we pull the customer's credit bureau report, we determine if the name, address, social security number and various other characteristics given by the customer match both the information on the I.D. presented and the information contained in the credit bureau report. In addition, our system is built to recognize various "fraud flags" in credit reports and also to request human review for any credit bureau report that contains a written "consumer statement." Questionable applications are referred for further processing to ensure that the applicant is in fact who they purport to be.

ID theft prevention does not stop when the credit application is approved. Many retailers like Boscov's have models or "neural networks" that identify unusual purchasing behavior. For example, if we see an account that is normally only used for small purchases suddenly being used to make large, high risk purchases on-line using a different shipping address, our systems will flag the transaction as "highly suspicious" and it will be referred to a special unit for investigation. We also have a number of customers who either have in the past been victims of identity theft or who believe they are likely to be victims. For these customers, we program our register system to immediately refer the sale to our credit center. Here we will verify the customer's identity via a valid ID or password.

Sadly, ID theft continues to grow and affect both of its victims: the merchant and the customer. Our losses related to ID theft continue to grow year after year despite our best efforts. We are constantly challenged to find new patterns in our many data sources that will help us identify fraudulent transactions without inconveniencing our legitimate customers. Without the ability to search all data sources available to us, ID theft would grow at an even greater rate. The ability to share, aggregate and search affiliate and third party data sources is paramount in the effort to protect Boscov's and our valued Boscov's customers.

Question – Is it true that An identity thief is able to obtain credit in the victim's name because Credit Bureaus discloses (sic) the victim's credit history when the imposter applies for credit? If so, is this a case of Information flow faciltating (sic) identity theft?

Answer – It is not generally true that an identity thief obtains the victim's name because a Credit Bureau discloses the victim's credit history when the imposter applies for credit. On the contrary, in order for a creditor to obtain the victim's credit bureau report, the identity thief must have already completed an application for credit indicating, typically, the victims name, address, social security number and date of birth.

Thus prior to the process of ever applying for credit, the identity thief has already obtained the victims personal information from some other source. Anecdotally, the sources that we most commonly see are medical and employment records which have been stolen from or improperly used by employees of the company in possession of this personal information.

Question – Should the information flow to consumers of their own info be "freer" than it is?

Answer – Customers who have had Adverse Action taken based on information contained in their credit bureau report have the right under FCRA to obtain a free copy of their credit bureau report. Credit Bureaus charge a nominal fee for consumers who have not been the subject of adverse action to obtain their credit information. Many companies offer "alert" services which constantly monitor a consumer's credit report and inform the consumer of inquiries, delinquencies, etc. which are posted the their reports.

In short, there are various "levels of service", provided by host companies in a full spectrum of price ranges. The consumer may then elect the level of service they deem most appropriate. I therefore see no need to make the flow of information "freer".

Question – Do you know how much Credit Bureaus charge consumers for ongoing electronic access to their credit reports or for alert services?

Answer – As noted above, the price is dependent upon the circumstances of the inquiry, level of service and company providing the information. Prices I am aware of range from Free to $5.00-$10.00 per month depending upon these variables.

Question – Do you know how much credit bureaus charge credit grantors for electronic access to a consumer's credit report?

Answer – The charge depends, again, on many variables such as purpose of the report (mortgage vs. employment vs. line of credit), the total volume of reports that a given creditor obtains on an annual basis, the delivery mechanism, which scores and other attributes are purchased amongst a host of others. I am aware of fees of less than $1.00 to fees of more than $25.00 depending upon these factors.

Question – How many disputes do credit bureaus received per month?

Answer – I do not know.

Question – How many people do Credit Bureaus have handling the volume of disputes?

Answer – I do not know.