THE ROLE OF FCRA IN THE CREDIT GRANTING PROCESS

HEARING

BEFORE THE

SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

JUNE 12, 2003

Printed for the use of the Committee on Financial Services

Serial No. 108–37

U.S. GOVERNMENT PRINTING OFFICE

91–542 PDF WASHINGTON : 2003

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

MICHAEL G. OXLEY, Ohio, *Chairman*

JAMES A. LEACH, Iowa
DOUG BEREUTER, Nebraska
RICHARD H. BAKER, Louisiana
SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
ROBERT W. NEY, Ohio
SUE W. KELLY, New York, *Vice Chair*
RON PAUL, Texas
PAUL E. GILLMOR, Ohio
JIM RYUN, Kansas
STEVEN C. LATOURETTE, Ohio
DONALD A. MANZULLO, Illinois
WALTER B. JONES, JR., North Carolina
DOUG OSE, California
JUDY BIGGERT, Illinois
MARK GREEN, Wisconsin
PATRICK J. TOOMEY, Pennsylvania
CHRISTOPHER SHAYS, Connecticut
JOHN B. SHADEGG, Arizona
VITO FOSSELLA, New York
GARY G. MILLER, California
MELISSA A. HART, Pennsylvania
SHELLEY MOORE CAPITO, West Virginia
PATRICK J. TIBERI, Ohio
MARK R. KENNEDY, Minnesota
TOM FEENEY, Florida
JEB HENSARLING, Texas
SCOTT GARRETT, New Jersey
TIM MURPHY, Pennsylvania
GINNY BROWN-WAITE, Florida
J. GRESHAM BARRETT, South Carolina
KATHERINE HARRIS, Florida
RICK RENZI, Arizona

BARNEY FRANK, Massachusetts
PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIERREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
DARLENE HOOLEY, Oregon
JULIA CARSON, Indiana
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
BARBARA LEE, California
JAY INSLEE, Washington
DENNIS MOORE, Kansas
CHARLES A. GONZALEZ, Texas
MICHAEL E. CAPUANO, Massachusetts
HAROLD E. FORD, JR., Tennessee
RUBÉN HINOJOSA, Texas
KEN LUCAS, Kentucky
JOSEPH CROWLEY, New York
WM. LACY CLAY, Missouri
STEVE ISRAEL, New York
MIKE ROSS, Arkansas
CAROLYN MCCARTHY, New York
JOE BACA, California
JIM MATHESON, Utah
STEPHEN F. LYNCH, Massachusetts
ARTUR DAVIS, Alabama
RAHM EMANUEL, Illinois
BRAD MILLER, North Carolina
DAVID SCOTT, Georgia

BERNARD SANDERS, Vermont

Robert U. Foster, III, *Staff Director*

Page

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

SPENCER BACHUS, Alabama, *Chairman*

STEVEN C. LATOURETTE, Ohio, *Vice Chairman*
DOUG BEREUTER, Nebraska
RICHARD H. BAKER, Louisiana
MICHAEL N. CASTLE, Delaware
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
SUE W. KELLY, New York
PAUL E. GILLMOR, Ohio
JIM RYUN, Kansas
WALTER B. JONES, JR, North Carolina
JUDY BIGGERT, Illinois
PATRICK J. TOOMEY, Pennsylvania
VITO FOSSELLA, New York
MELISSA A. HART, Pennsylvania
SHELLEY MOORE CAPITO, West Virginia
PATRICK J. TIBERI, Ohio
MARK R. KENNEDY, Minnesota
TOM FEENEY, Florida
JEB HENSARLING, Texas
SCOTT GARRETT, New Jersey
TIM MURPHY, Pennsylvania
GINNY BROWN-WAITE, Florida
J. GRESHAM BARRETT, South Carolina
RICK RENZI, Arizona

BERNARD SANDERS, Vermont
CAROLYN B. MALONEY, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
LUIS V. GUTIERREZ, Illinois
DENNIS MOORE, Kansas
CHARLES A. GONZALEZ, Texas
PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
DARLENE HOOLEY, Oregon
JULIA CARSON, Indiana
HAROLD E. FORD, JR., Tennessee
RUBÉN HINOJOSA, Texas
KEN LUCAS, Kentucky
JOSEPH CROWLEY, New York
STEVE ISRAEL, New York
MIKE ROSS, Arkansas
CAROLYN MCCARTHY, New York
ARTUR DAVIS, Alabama

CONTENTS

Page

Hearing held on:
June 12, 2003 1
Appendix:
June 12, 2003 67

WITNESSES

THURSDAY, JUNE 12, 2003

Cloutier, C.R., President, MidSouth National Bank, Lafayette, LA, Chairman, Independent Community Bankers of America 47
Courson, John A., Chairman, Mortgage Bankers Association 8
Fishbein, Allen, General Counsel, Center for Community Change 15
Gambill, Harry, Editor Publisher, CEO, TransUnion LLC 18
Hendricks, Evan, Editor, *Privacy Times* 53
Hildebrand, Scott, Vice President, Direct Marketing Services, Capital One Financial Corporation 57
Loban, George B., Co-Chairman and President, FSF Financial Corporation and First Federal FSB, Hutchinson, MN, on behalf of America's Community Banker 49
Manning, Robert, Caroline Werner Gannett Professor of Humanities, Rochester Institute of Technology 51
Moskowitz, David, General Counsel, Wells Fargo Home Mortgage 9
Pickel, A.W. III, President and CEO, Leader Mortgage Company, Lenexa, KS, President-Elect, National Association of Mortgage Brokers 11
Plunkett, Travis B., Legislative Director, Consumer Federation of America 13
Vadala, Michael, President and CEO, The Summit Federal Credit Union, on behalf of the National Association of Federal Credit Unions 45
Wong, Martin, General Counsel, Global Consumer Group, Citigroup, Inc. 55

APPENDIX

Prepared statements:
Bachus, Hon. Spencer 68
Gillmor, Hon. Paul E. 71
Hinojosa, Hon. Rubén 72
Cloutier, C. R. 73
Courson, John A. 79
Fishbein, Allen 85
Gambill, Harry 94
Hendricks, Evan 109
Hildebrand, Scott 122
Loban, George B. 132
Manning, Robert 138
Moskowitz, David 167
Pickel, A.W. III 174
Plunkett, Travis B. 182
Vadala, Michael 197
Wong, Martin 207

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Maloney, Hon. Carolyn:
"Cash-Outs Let Homeowners Share the Wealth," article, *The Washington Post,* June 8, 2003 215

	Page
Courson, John A.:	
Written response to questions from Hon. Rubén Hinojosa	219
Gambill, Harry:	
Written response to questions from Hon. Rubén Hinojosa	222
Loban, George B:	
Written response to questions from Hon. Rubén Hinojosa	233
Moskowitz, David:	
Written response to questions from Hon. Rubén Hinojosa	235
Pickell, A.W. III:	
Written response to questions from Hon. Rubén Hinojosa	239
Vadala, Michael:	
Written response to questions from Hon. Rubén Hinojosa	244
Fannie Mae, prepared statement	245

THE ROLE OF FCRA IN THE CREDIT GRANTING PROCESS

Thursday, June 12, 2003

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

The subcommittee met, pursuant to call, at 10:11 a.m., in Room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the subcommittee] presiding.

Present: Representatives Bachus, Royce, Lucas of Oklahoma, Capito, Tiberi, Feeney, Hensarling, Brown-Waite, Barrett, Hart, Renzi, Miller, Sanders, Maloney, Watt, Meeks, Gutierrez, Waters, Velaquez, Hooley, Hinojosa, Lucas of Kentucky, Crowley, Israel and Davis.

Chairman BACHUS. [Presiding.] Good morning.

Our hearing today is another installment in a series of hearings the subcommittee is holding with respect to the Fair Credit Reporting Act. The provisions in FCRA that guarantee a single national standard with respect to many of the FCRA provisions are set to expire January the 1st of 2004. As I Stated last week, my primary focus throughout this debate will remain on providing consumers and the economy with the strong protections and benefits of the law.

At our last hearing, we had more than twenty witnesses. They described why and how FCRA is important to consumers, and the economy as a whole. Today we will focus on the credit granting process and the role of FCRA in facilitating the most robust credit market in the world.

The process of applying for a personal loan, car loan or even a credit card has become increasingly simple. The consumer fills out a brief application, and within a matter of minutes, the consumer will know whether he or she has qualified for credit. The Chairman of the Federal Trade Commission, Timothy Muris, has referred to this as the miracle of instant credit. Even the mortgage underwriting process has become much less complicated, as millions of Americans are demonstrating each month.

Today, new homeowners can spend more time picking out new curtains and wallpaper, because they spend less time on mortgage paperwork and stress. It should be obvious that these improvements in the credit-granting process benefit consumers.

Our witnesses today will provide us with the complete picture of how FCRA operates as part of the credit-granting process. Our first panel will focus on how lenders assist millions of Americans in realizing the dream of home ownership. Just as importantly, we will also learn how a credit reporting agency, commonly known as a credit bureau, facilitates the credit-granting process.

The first panel will also include witnesses representing consumer groups. Our second panel will review the credit-granting process in a broader scope. We will hear from representatives of a credit union, smaller banks, a large bank and a credit card issuer. Each will describe how the FCRA affects their ability to make credit widely available to American consumers.

We will hear from other witnesses describing some potential pitfalls of the credit-granting process. I, for one, am particularly interested in how the national standards established by certain provisions of FCRA relate to the credit-granting process. For example, I am interested in learning whether FCRA has facilitated a national credit market and whether having a national system is beneficial.

More importantly, if the national uniformity in place today were replaced with a patchwork quilt of inconsistent State laws, would consumers face a less convenient and more expensive credit-granting process?

I want to thank Chairman Oxley, Ranking Member Frank and Mr. Sanders for working with me on FCRA re-authorization. I believe the bipartisan cooperation that we have had on this important issue to date has been helpful in the debate.

Today, we have accommodated all four of the minority witness requests.

I look forward to our witnesses' testimony on how the FCRA facilitates the most advance credit underwriting process in the world and how it benefits consumers.

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

[The prepared statement of Hon. Spencer Bachus can be found on page 68 in the appendix.]

Mr. SANDERS. Thank you very much, Mr. Chairman, for convening this very important hearing. We have an excellent panel of witnesses. And I look forward to hearing from them all.

I will be running in and out because of other commitments. But I will be listening attentively to what all of our witnesses have to say.

What I have been hearing from the banking and credit card industry is that consumers have never had it so good, that consumers are reaping billions of dollars in savings due to lower interest rates and that consumers have a much easier time accessing credit.

It may be true that the credit card industry and the CEOs have never had it so good. According to the FDIC, credit card lenders and the banking industry reported record-breaking profits in the first quarter of this year while revenue from credit card fees have increased dramatically, from $7.3 billion in 1994 to $23.9 billion in 2001.

So I think one of the areas, Mr. Chairman, that we are going to want to take a hard look at is what is going on with credit card fees, not just interest rates. And fees now account for 31 percent of credit card industry income. And that is an issue, I think, that needs a lot of study.

Is gaining access to credit a good thing? Well, obviously, it is in many instances, but sometimes it is not. According to Dr. Manning, credit card debt has skyrocketed, from approximately $51 billion in 1980 to over $610 billion in 2002. At the same time that consumers are bombarded by a record 5 billion credit card solicitations. Now, that is an incredible number.

My understanding is, and somebody else can do the arithmetic, that the American people receive 5 billion credit card applications a year. And I suspect my son receives about half of them. Not his father, but my son.

And the largest increase in credit card debt is among consumers making $10,000 a year or less. Three-fourths of college students use their student loans to pay their credit card bills. And the average credit card debt per consumer has risen from $10,000 in 1998 to $12,000 in 2002, which is not good.

Mr. Chairman, there is another issue that I certainly am going to be focusing on today, and I hope you will, as well. And there were major stories in The New York Times, ABC World News, Washington Post on what I consider to be a scam, and nothing less than a scam. And that is, as part of the 5 billion solicitations that take place each year, the credit card companies say, Well, sign up with us, 3 percent interest rate. Not a bad deal. Somebody signs up for 3 percent interest rate. Suddenly, three months later, they are paying 25 percent, 29 percent interest rate. What happened?

Did they not pay their credit card payments on time? Were they late? Did they default? The answer is in every instance, they may well have paid what they owed the credit card on time, but perhaps they borrowed some money, went to the bank as the result of an illness in the family, borrowed some more money. Maybe they were late paying an auto loan two months before. Maybe 3 years ago they were late on their mortgage, and out of nowhere their interest rates have skyrocketed.

This is a scam. It is causing severe problems for large numbers of credit card borrowers in America, and it is something that we want to address.

So, Mr. Chairman, this is an important day. We have got a lot of excellent panelists. And I thank you very much for working with us to bring those panelists here.

I would yield back the balance of my time.

Chairman BACHUS. Thank you.

Are there other members who wish to make an opening statement?

Ms. Hooley?

Oh, Mr. Gutierrez, I am sorry.

Mr. GUTIERREZ. Thank you, Mr. Chairman.

Well, I am happy to be here today to discuss the role of FCRA in the credit-granting process. A major concern I have is the increased use of the insurance scores and the lack of information about these scores available to consumers. I think we should research the increased use of credit-based insurance scoring and excessive negative impact it is having on the consumer's ability to purchase insurance coverage. Low credit scores can prevent someone from being insured at all. In fact, this has stirred complaints across the country, from consumers who feel that the use of credit scoring for services unrelated to credit is both discriminatory and invasive.

The mix of information is used to compile a credit score, which includes much more than just the timeliness of payments. The methodology includes items such as outstanding debt a person has and the number and type of open credit lines. Given the fact that currently 90 percent of property insurers use credit scoring as a determining factor in their approval process and as a means to derive rates, we have an obligation to look at this matter carefully.

A major problem with the use of these scores is the lack of consistency in how scores are established and unwillingness on the part of insurers to reveal publicly how they determine scores. Without a standard to fall back on and without insurance companies being required to reveal how they tabulate score, there is no way to make sure consumers are protected from discrimination.

We should look at, Mr. Chairman, just how it is we have credit scoring and insurance scoring, as one is tied to the other.

I thank the chairman for the timeliness of the hearing and I look forward to the testimony today.

Chairman BACHUS. I thank you.

Go ahead, I am sorry.

Mr. ISRAEL. Thank you, Mr. Chairman. I will be very brief.

One of the principal concerns that I have had with FCRA is, in my view, the unfair and even unpatriotic practice of harassing families of deployed military personnel for late payments or scoring against someone who is sitting in a Humvee in Iraq a late payment.

It seems fundamentally unfair to me that somebody who is willing to lay his or her life on the line for our freedoms today is going to be denied credit tomorrow because they could not make a payment or were late making a payment while being deployed in very dangerous parts of the world.

I have been focusing on this issue with some of my colleagues. And I want to continue focusing on this issue and hope that during questions and answers we can address that critical and very important issue.

And I look forward to working with you, Mr. Chairman, on a bipartisan basis to continue developing a response to what is a very significant problem for our activated military personnel.

And I thank the chairman.

Chairman BACHUS. Thank you, Mr. Israel.

Ms. Hooley, and then Ms. Waters?

Ms. HOOLEY. Thank you, Mr. Chairman.

Very briefly, I am glad we are having these hearings. Of hearings, I think it is incredibly important. It is important to consumers, as well as to our credit system and our economy. I do think we have the best credit system in the world, and hopefully we will take positive steps to ensure the supremacy of our credit system, that it continues.

While I am happy having these hearings, I am becoming more and more concerned about the lack of movement from the administration. I know we had the undersecretary here earlier. We have been told that they would have something ready in June. I have now heard rumors, and I hope they are just rumors, that we won't be ready until mid-July.

I hope we do not delay on this issue. I think, again, it is an issue that we need to deal with, not only for our economy, but for consumers. And I just think this attention deserves attention from the White House, as much as this subcommittee has provided for this issue.

I am looking forward to the rest of our hearings. And, again, I would like to thank the ranking member and the chairman for having these hearings. I think they are incredibly important.

Thank you.

I yield back the remainder of my time.

Chairman BACHUS. Thank you.

Gentlelady from California?

Ms. WATERS. Well, thank you very much, Mr. Chairman.

I would like to thank both you and our ranking member, Congressman Sanders, for this hearing today.

Today we have the opportunity to discuss one of the most important issues facing this subcommittee all year, the ability of consumers to have access to accurate credit information, maintain their privacy and be given the ability to safely conduct their business without having their identity stolen.

The Fair Credit Reporting Act was originally enacted by Congress in 1970 to bring the consumer credit reporting industry under Federal regulation and create certain obligations and rights governing credit reporting transactions. The 1996 amendments to the Fair Credit Reporting Act were designed to address widespread problems experienced by consumers who were going to buy credit are being charged too much for inaccuracies in their credit reports.

We all understand the need to have easy access to credit information and to have a uniform national standard. It is equally important that the information be correct. According to the Consumer Federation of America and the National Credit Reporting Association, who conducted an exhaustive study of over 500,000 credit reports, they found that nearly eight out of 10 files, 78.4 percent, were missing a revolving account in good standing.

In addition, one file out of three, 33.3 percent, was missing a mortgage account that had never been late. And two files out of three, 66.7 percent, were missing another type of installment account that had never been paid late. This includes mistaken identities, misapplied charges, uncorrected errors, misleading information and variation between information reported by the various credit repositories.

Part of the solution to strengthening consumer accuracy and access to their credit report can be found in the State of California. Consumer reporting agencies must disclose the names and addresses of all sources of information used in the consumer's report. California also requires consumer reporting agencies to, with a reasonable degree of certainty, match at least three categories of identifying information within the consumer's file with the information provided by a retailer. The categories of identifying information may include the consumer's first and last name, month and date of birth, driver's license number, place of employment, current residence, previous residence or Social Security number. This effectively reduces a successful attempt at identity theft, and reduces the chance for mistaken identity.

Also in the California law a consumer has a right to receive his or her credit score, the key factors and any related information. Under new provisions, a consumer would be able to have a security freeze placed on his or her credit report by making a request in writing by certified mail with the consumer credit reporting agency.

A security freeze prohibits the consumer reporting agency from releasing the consumer's credit report, or any information from it, without the expressed authorization of the consumer. Effective July 1, 2003, upon receipt from a victim of identity theft of a police report or a valid investigative report, a consumer reporting agency must provide a victim of identity theft with up to 12 copies of their credit report for the consecutive 12 month period free of charge.

These examples create the opportunity for banks, credit card companies, department stores and auto financing and other furnishers who provide accurate information voluntarily to complete a report, the full scope of information, increasing the likelihood credit bureaus will not miss any negative information. With strong consumer protections, Federal preemption of States would not be necessary because Federal law would be the doer rather than the seller.

I yield back the balance of my time.

Chairman BACHUS. Are there any other opening statements?

Let's first introduce this panel. We have a very, I think, esteemed group of panelists.

John Courson is president and CEO of Central Pacific Mortgage Company, located in Folsom, California. Mr. Courson is also chairman of the Mortgage Bankers Association of America. Prior to that, he was the CEO of Westwood Mortgage Company and president and COO of Fundamental Mortgage Company.

And I note one thing interesting about his resume is that he served as president of the California and the Michigan Mortgage Bankers Association, and as a director of the Texas Mortgage Bankers Association, so quite a few positions in different States.

David Moskowitz is senior vice president, secretary and general counsel for Wells Fargo Home Mortgage. He has been in that position since 1994. Prior to that, he was with Prudential Home Mortgage Company, where he was associate general counsel, and Perpetual Mortgage Company in McLean, Virginia, prior to that as general counsel. Educated at Union College in Schenectady, New York, he has a law degree from Case Western, and admitted to several different State bar associations.

A.W. Pickel III, is currently president and CEO of Leader Mortgage Company, a mortgage banker broker company headquartered in Lenexa, Kansas. He is president-elect of the National Association of Mortgage Brokers. He graduated from the University of Illinois, Urbana-Champaign, in accounting. And as I mentioned to him earlier, he then went to work for an international Christian organization known as the Navigators, where he worked with college students at major universities. And I can personally tell you that the Navigators have been very meaningful to me.

And I know several of folks who do the same thing you do, very dedicated people. I commend you for that work. A long list of different awards, too numerous, really, to mention. But we welcome you to our hearing today.

Travis Plunkett, he serves as the Consumer Federation of America's chief liaison to members of Congress, to Federal regulators and to agency administrators. Consumer Federation of America is a non-profit association of over 300 organizations that advances the consumers' interests through advocacy and education, has a combined membership of 50 million Americans. Its primary focus is on credit reporting, bankruptcy, credit counseling, consumer privacy and insurance. Frequently interviewed by national and news media, written a number of consumer guides. He holds a Bachelor of Arts from the great University of Denver. I noted that you served in the U.S. Army intelligence and security commands. So Mr. Israel, some of his questions might also be something you could shed light on.

Allen Fishbein, general counsel of the Center for Community Change, he specializes in the area of expanding the availability of responsible lending and banking services for the underserved. He testified before our committee before.

And actually, Mr. Fishbein, we are going to have a hearing, I guess, later in the month on the underserved and how to better reach them with banking services, something that I am sure you could assist us with.

Prior to joining the Center, he was senior adviser for government-sponsored enterprise oversight, Fannie Mae and Freddie Mac. He supervised the department rule-making process at HUD for new affordable housing goals for the two enterprises. He has written several books. Past member of the Federal Reserve Board's Consumer Advisory Council. And I close by saying that he has been honored by the District of Columbia Bar as Consumer Lawyer of the Year with a degree from Antioch School of Law, here in Washington, D.C.

Mr. Gambill, present chief executive officer of TransUnion, joined TransUnion in 1985, rose, obviously, up through the ranks to the top position. Prior to joining TransUnion, Mr. Gambill was regional credit manager for Rhodes Furniture in Atlanta, Georgia, and also held management positions at Belth Department stores and Sears Roebuck.

So, you can obviously give us a good view, from your background both from a credit reporting agency and also from a furnisher of information to a Credit Bureau.

He has a Bachelor of Science degree in Business Administration from Arkansas State, and also served in the U.S. Army for six years, and, as I was, he was an enlisted man who rose up through the ranks. That is why I have such fear of generals, even today.

[Laughter.]

He became a staff sergeant, which is a very respected position.

An Arkansas native, currently resides in Aurora, Illinois, with your wife, and you have two children.

With that, we will start with Mr. Courson, chairman of the Mortgage Bankers Association, and go just in order.

Thank you.

STATEMENT OF JOHN A. COURSON, CHAIRMAN, MORTGAGE BANKERS' ASSOCIATION

Mr. COURSON. Good morning, Mr. Chairman, and members of the subcommittee.

I want to thank you for inviting MBA to participate in this very important discussion. I am proud to testify this month, in June, which has been designated by the president as Homeownership Month. I applaud the subcommittee for holding these hearings and giving the mortgage finance industry an opportunity to share with you the great success that our nation and its homeowners have experienced as a result of having the American dream met, due in part, to the Fair Credit Reporting Act.

Let me share with you, if I may for just a moment, some of that success. As you know, home ownership brings good things to our citizens and to our economy. In the last 2 years, over $100 billion has been put back into the economy from refinancing of real eState. The real eState sector employs 1.36 million, of which approximately about 500,000 come from our industry, the mortgage lending industry.

FCRA plays an integral role in this success by creating a structure that produces reliable consumer information used to lower the cost of home ownership, offers the dream of home ownership to underserved markets and produces innovative mortgage products.

I am here today to strongly recommend that you reauthorize the preemptions contained in FCRA in their current form and maintain the national standards, uniformity and protections.

Let me emphasize, Mr. Chairman, FCRA has national standards, uniformity and protections, all important for consumers and the mortgage industry because it gives rise to the following benefits.

It enables Americans to move to new States and purchase homes with relative ease. It lowers the cost of credit to consumers, as lenders compete for customers on a national level. It speeds the consumer's access to credit, as mortgage lenders underwrite loans assisted by automated systems that provide a timely response to the consumer's mortgage application. And it permits lenders to evaluate risks more accurately through the analysis of consumer credit data, thereby enabling mortgage lenders to extend credit to Americans who, under traditional evaluation models, were considered too great of a risk.

And it allows for greater innovation in mortgage products, as lenders take a successful product in one State and implement it in another State, allowing those consumers to also benefit.

Seven important Federal preemptions included in FCRA's 1996 amendments provide standards of accuracy, consistency and uniformity among the users of consumer information: those who report consumer information and credit bureaus that collect and distribute information. The preemptions, which Congress included on an experimental basis, also provide for consumer protections, to prevent the misuse and inaccurate reporting of consumer information.

The mortgage lending industry believes FCRA and the preemptions within it have proven to be a financial success for consumers and the economy, and should be extended and made permanent.

You know, the United States, Mr. Chairman, has the best mortgage finance system in the world. Should Congress decide to dismantle part of this well-operating structure, it will negatively affect the availability and cost of mortgage products in this country. The following are just a few examples.

The cost of credit for consumers will increase as lenders who currently operate under national standards face higher costs to discover and comply with the myriad of State laws. Consumers will have fewer lenders among which to choose as varying non-uniform State laws give rise to regional barriers that will make it difficult to operate nationally.

Innovation in mortgage products will slow, as non-uniform standards set forth in disparate State laws decrease the amount of available consumer information, which is necessary for advancements to better serve the needs of our borrowers. Further, consumers will face a patchwork of protections with inconsistent and fragmented State laws.

The housing market is serving consumers, the mortgage lending industry and the economy well. It is important to note that housing has been a tremendous support to a weak economy in recent years. Failing to reauthorize the standards, uniformity and protections of FCRA would have severe adverse effects on serving our customers and your constituents.

I thank you for inviting the Mortgage Bankers Association to testify, and look forward to answering your questions.

[The prepared statement of John A. Courson can be found on page 79 in the appendix.]

Chairman BACHUS. Thank you.

Mr. Moskowitz?

STATEMENT OF DAVID MOSKOWITZ, GENERAL COUNSEL, WELLS FARGO HOME MORTGAGE

Mr. MOSKOWITZ. Thank you, Chairman Bachus, Ranking Member Sanders and members of the subcommittee.

My name is David Moskowitz, and I am general counsel for Wells Fargo Home Mortgage, headquartered in Des Moines, Iowa. Wells Fargo, our parent company, is a diversified financial services company offering mortgage, securities, insurance, real eState services, online banking, institutional and retail banking products under the Wells Fargo brand through a number of separately incorporated affiliates to 15 million customers nationwide. Wells Fargo's headquarters is in San Francisco. The company has 130,000 employees, has mortgage offices nationwide, has a retail banking presence in 23 States.

I thank you for the invitation to testify today. I would like to share with you some of Wells Fargo Home Mortgage's experiences in providing products and services within the framework established by the Fair Credit Reporting Act.

Wells Fargo Home Mortgage works in concert with its other Wells Fargo business affiliates in providing financial service products to its customers. Marketplace experience shows that consumers expect that the financial service companies they do business with to know about their accounts, to respond quickly to their questions and to advise them about products and services that will help them reach their financial goals.

The service consumers expect requires that Wells Fargo have integrated information systems to give consumers what they want, when, where and how they want it. Subject to the Fair Credit Reporting Act, Wells Fargo shares customer information internally to meet these goals.

Providing a new mortgage, refinancing an existing mortgage and meeting our contractual servicing requirements for investors and our customers requires information about their financial affairs. Applying inappropriate restrictions on transfers of information among affiliates would impede customer service.

The 1996 amendments to the Fair Credit Reporting Act recognized the value to customers of the ability to transfer information among affiliates. This ability is wholly consistent with consumers' expectations that their questions will be answered and their needs will be met with a single call or a single e-mail message, whether their financial products are provided by a single company or several companies in the same affiliated group. To put it another way, customers do not care whether for technical, regulatory or management reasons, Wells Fargo chooses to organize itself into a particular series of affiliates of a holding company or subsidiaries of one bank.

What customers do care about is the seamless delivery of the products Wells Fargo offers, regardless of how we choose to distribute them.

In Wells Fargo's view, it is consumer expectations and needs that should shape the public policy that regulates information use, not legal structure. Because of legal requirements that prohibited or restricted bank branching, Wells Fargo, at one time, owned numerous separately incorporated banks. The Riegle-Neal Act of 1994 allowed bank holding companies to consolidate banks into as few as a single charter. Today, for business reasons, rather than legal reasons, Wells Fargo owns 28 separately chartered banks, but the number of separate banks that a holding company chooses to have should not affect public policy relating to information use.

If a bank holding company conducts its banking business in a single bank entity, that bank would have all the information about a customer who had deposits, a mortgage, a credit card, a home equity loan from that bank. As a single corporate entity, it could use this information without restriction to serve its customer.

If, on the other hand, the bank holding company chooses to conduct its mortgage, credit card and home equity loan businesses in three separately incorporated banks, and the law restricted the sharing of information among affiliates, a customer who supplied the same information for the same products at three affiliated institutions, instead of a single institution, would not receive the same level of service from its financial services company.

To use customer information to provide the same level of service that could be provided by a single entity with the same information about the same customer, a holding company like Wells Fargo that provides services through multiple banks and non-bank charters would have to consolidate its operation into as few charters as legally possible.

Because of the uncertainties of the outcome of the FCRA debate, institutions like Wells Fargo will likely change their corporate structures to reduce the number of separate entities, rather than risk restrictions on information sharing among affiliates.

It is our view that corporate structure should not be a factor in setting public policy regarding information use. The touchstone, instead, should be consumer expectation. This is especially critical to our mortgage business.

Since passage of the 1996 amendment to the Fair Credit Reporting Act, mortgage servicing has become more efficient. Wells Fargo customers have more channels through which they can apply for a mortgage and get assistance or conduct transactions related to a mortgage, as well as a complete array of financial products offered by Wells Fargo. With affiliate transfers and use of customer information, mortgage customers can make a mortgage payment at their local bank branch, obtain balances, get consolidated statements and get the support of 24-hour call centers that serve an entire affiliated enterprise.

It is our goal to provide seamless service and product advice to customers no matter which member of the Wells Fargo family of companies provide the particular product or services.

With the FCRA framework, companies can do a better job of evaluating credit and market risks. This translates into better and lower cost service to customers. Wells Fargo can offer a variety of mortgage service and products, such as quick turn-around on refinancing, discounts on closing costs for signing up with Wells Fargo's product line, referrals for new homeowners and alternative financing options for customers.

Finally, Wells Fargo believes the current uniform national standard for information use, as provided by the 1996 amendments to the FCRA, is vital, and asks that this Congress provide clarity and stability by removing the sunset provisions that affect affiliate sharing and other segments of credit granting.

Congress should also address identity theft and should grant authority to bank regulators to set new national standards for notices about information use to customers. The problem of identity theft and complicated notices about information use are frustrating to both customers and financial service providers. The availability of financial services, such as mortgages, for our customers and the flow of information required to make those services available, do not stop at State borders or corporate structures.

Thank you. And I would be happy to answer any questions that you, Chairman Bachus, or the subcommittee may have.

[The prepared statement of David Moskowitz can be found on page 167 in the appendix.]

Chairman BACHUS. Thank you, Mr. Moskowitz.

Mr. Pickel?

STATEMENT OF A.W. PICKEL, III, PRESIDENT AND CEO, LEADER MORTGAGE COMPANY, LENEXA, KS, PRESIDENT-ELECT, NATIONAL ASSOCIATION OF MORTGAGE BANKERS

Mr. PICKEL. Chairman Bachus, Congressman Sanders, and members of the committee, I am A.W. Pickel, president-elect of the National Association of Mortgage Brokers, and president of Leader Mortgage Company in Lenexa, Kansas.

I appreciate the opportunity to present NAMB's views on the Fair Credit Reporting Act. NAMB is the nation's largest organization exclusively representing the interests of the mortgage brokerage industry, and has more than 14,000 members.

Thank you, really. I appreciate it, for having us here.

I want to commend this committee for holding a series of hearings on an issue that is vital to our economy and to consumers. FCRA, as amended, provides a carefully constructed balance, which creates uniform national standards that have increased the effectiveness of consumer report information.

This national uniform standard impacts nearly every business sector that makes consumer credit-related decisions. It is also essential to the operation of our current mortgage industry. As it is estimated that mortgage brokers originate more than 60 percent of all the residential mortgages, NAMB is very concerned of the impact changes to FCRA may have on the mortgage marketplace and the economy, in general.

FCRA has facilitated the information that is provided by consumer reporting agencies, which is mandatory to make sound mortgage lending decisions and to help evaluate risk. This information is essential in order for the mortgage industry to provide consumers with access to credit and reasonably priced products. A carefully constructed balance in FCRA creates the ability to make quick decisions on offers of credit that is critical to both consumers and mortgage originators. It also creates competition, which helps to lower credit costs for consumers.

NAMB believes the extension of the preemption provisions are necessary to preserve a national uniform standard, some of which I will address today. If Congress allows the preemption provisions in FCRA to expire, the outcome of such inaction will increase risks and costs for mortgage originators, and as such, will have a detrimental impact on a consumer's access to credit and availability of mortgage products.

Applying for a mortgage was a very time-consuming process before the carefully constructed balance of FCRA was created. Processing a mortgage application required personal contacts with references, other creditors and contact with individuals who had knowledge of a consumer's personal finance history.

Now, consumers can gain access to credit virtually instantaneously on a wide array of credit products.

The information contained in a consumer report is an essential component to the mortgage process. It dictates the terms and rates for a consumer's mortgage. If States are allowed to enact inconsistent laws regarding what information can and cannot be contained in a consumer report, the ability for mortgage originators to determine a consumer's credit risk will be compromised.

Accurate reports benefit not only the consumer, but also the mortgage broker and the lender, who are able to make more rapid and accurate credit decisions utilizing these scoring models when underwriting a mortgage loan. The lack of a national standard on the contents of a consumer report would add a level of uncertainty in the risk profile of the consumer's credit history. As a result, the price of credit will increase for all consumers, and access to credit will be reduced, which could result in a reduction in our country's historically high homeownership rate, something that NAMB is very proud of.

Uniform adverse action notices provide a consumer with consistent information regardless of their location. If this preemption provision expires, an adverse action notice may differ from State to State. This could result in confusion to consumers and a significant increase in operational costs to the industry, from which consumers will suffer the consequences.

Mortgage brokers generally do not furnish information to consumer reporting agencies. However, the lenders with which mortgage brokers transact business and many other industry sectors do furnish information to consumer reporting agencies. If States are allowed to enact inconsistent laws regarding furnisher requirements, furnishers may decide that compliance with different State laws is too burdensome and may choose not to submit the information at all, making consumer reports both inaccurate and unreliable.

Finally, we also think that the procedures for disputing inaccurate information need to maintain uniformity. Inconsistent investigation time restrictions would lead to a cursory and inaccurate investigation to the detriment of consumers. Mortgage brokers often work with consumers to help them to review and correctly dispute items on their credit report, when necessary to obtain the most rapid modifications necessary to obtain the best mortgage for them. Cursory and inaccurate investigations of credit disputes will frustrate this working relationship between a mortgage broker and their consumer.

NAMB believes it is important that Congress maintain our current uniform credit system, which has provided the economy with strong benefits and protections and has enabled millions of consumers to obtain the dream of home ownership.

Thank you very much for the opportunity to testify here today.

[The prepared statement of A.W. Pickel can be found on page 174 in the appendix.]

Chairman BACHUS. Thank you, Mr. Pickel.

Mr. Plunkett, we welcome your testimony.

STATEMENT OF TRAVIS B. PLUNKETT, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA

Mr. PLUNKETT. Good morning, Chairman and Ranking Member Sanders.

My name is Travis Plunkett. I am the legislative director of the Consumer Federation of America. Thank you very much for the opportunity to offer our comments on the important issue of the role of the Fair Credit Reporting Act in the granting of mortgage loans.

I have three main points I will touch on today.

First, accuracy and completeness of information about consumers' credit history is the very foundation on which the entire credit reporting system is built. And that foundation is shaky. We agree that there have been positive effects to the automation of credit reporting over the last 15 years, but broad and credible evidence demonstrates that the status quo has led to serious problems with credit reporting accuracy and completeness.

Second point: The furnishers of credit reporting data—creditors, collection agencies and others—are responsible for many accuracy and completeness problems. Provisions of the Fair Credit Reporting Act to require furnisher accountability need to be improved.

Third point, the dispute resolution process under the Fair Credit Reporting Act, which is supposed to help consumers resolve problems with credit reporting accuracy, is flawed and is becoming obsolete. It needs to be overhauled and modernized.

Now, let me touch on each of these points briefly and tell you that there is a lot of detail and specific recommendations in my written testimony on each point.

On accuracy, we agree with Howard Beals, the director of the Bureau of Consumer Protection at the Federal Trade Commission, in speaking about credit scoring and the trend towards credit scoring. He said, "Even small differences in a consumer's credit score can influence the cost or other terms of the credit offer, or even make the difference between getting approved or denied. Accuracy of the information underlying the score calculation is paramount."

A study released by the Consumer Federation of America and the National Credit Reporting Association has found dramatic and costly discrepancies in credit scores in underlying credit information among credit repositories. We looked at half a million actual mortgage consumers seeking mortgage credit. Researchers then closely examined the files of consumers with scores near the 620 cutoff; this is the commonly known dividing line between prime lower-cost mortgage credit and sub-prime higher-cost credit.

The study found wide variations in credit scores for a given consumer among the three national credit repositories. The average discrepancy for all consumers was 41 points. The credit scores for nearly one in three consumers varied by 50 points or more. In credit scores for one in 25 varied by 100 points or more. This means that roughly 8 million consumers, one in five of those who are on this borderline, are likely to be misclassified as sub-prime upon applying for a mortgage.

A similar number of consumers are likely to benefit from errors in their report. However, I don't think anybody in this room would argue that individual consumers benefit from system-wide averages like this. And I don't think anybody in the room would agree that consumers should have to cope with a credit reporting system that functions like a lottery.

Falling below the cutoff score for prime mortgage can lead to a complete denial of credit or be extremely costly. We threw out an example in our written testimony. The upshot is we compare an A-loan, less than ideal credit, to an A loan. The consumer at A would pay $124,000 more in interest payments over the life of a 30-year fixed $150,000 mortgage. There is a detailed analysis in the testimony of this report.

Let me add that the Federal Reserve has come to similar completions about one aspect of the problem that we highlight, and that is the completeness of reporting by creditors. The primary area of concern that they identify with data integrity was that of missing credit limits. This can have a major detrimental effect on consumers' credit score and on their credit rating overall.

The Controller of the Currency has also raised concerns about complete reporting, as has the Federal Financial Institutions Examination Counsel, which brings me to closing and to highlight the second and third issues that I mentioned at the top.

If one of the major problems is inaccurate and incomplete reporting by the furnishers, then we need to go and look at many of the recommendations that have been thrown out by CFA and others to increase complete reporting by those furnishers. We suggest if they use the system, voluntary approach, if they use the credit reporting system, they need to report everything.

Finally, we need to look at our dispute resolution process. It doesn't allow consumers access to their credit score in most cases. Most States don't allow it and FICRA doesn't allow it, and it doesn't allow consumers to get quick, timely access to their report to correct errors and get that good credit offer, that good mortgage loan or that other offer of credit that they would like to get. It is a serious problem, and we need to look at modernizing the dispute resolution process.

Thank you.

[The prepared statement of Travis B. Plunkett can be found on page 182 in the appendix.]

Chairman BACHUS. Thank you, Mr. Plunkett.

Mr. Fishbein?

STATEMENT OF ALLEN FISHBEIN, GENERAL COUNSEL, CENTER FOR COMMUNITY CHANGE

Mr. FISHBEIN. Thank you, Mr. Chairman, and Mr. Sanders and members of the subcommittee.

My name is Allen Fishbein, and I am general counsel of the Center for Community Change. I want to thank you for the opportunity to testify today and share my thoughts at this hearing on the role of FCRA and the credit-granting process.

My written testimony focuses on a series of issues pertaining to the impact of credit scoring and automated underwriting in providing fair access to mortgage credit, which we think bears on the issues that are the concern of this hearing.

In 1969, during the debate on the original FCRA, Senator Proxmire spoke of the congressional intent behind the law, saying that the aim of FCRA is to see that the credit report system serves the consumer as well as the industry. "The consumer has a right to information which is accurate. He has a right to correct inaccurate or misleading information," said Senator Proxmire. "And he has the right to know when inaccurate information is entered into his file. The Fair Credit Reporting Act seeks to secure these rights."

Referring to this legislative intent, last year, William Lund with Maine's Office of Consumer Regulation Stated, "Just as the FCRA demystified the storage and the use of credit information, credit scoring is now serving to re-mystify that process." And we share the regulator's concern.

The rapid growth in the use of credit scoring and related technologies have worked to improve access to credit for many, particularly in mortgage lending. However, it also has added an additional veil of secrecy over the credit decision-making process. This veil has created uncertainty and suspicions among consumers about the role that these scoring technologies play as gatekeepers for obtaining credit. Lifting this veil, particularly for the mortgage lending arena, is long overdue, but is likely to require congressional action to achieve.

Let me highlight the main points that are in my written testimony in the time I have this morning, let me say that there have been great changes in consumer credit reporting and consumer credit decisions since FCRA was originally enacted, and even since the 1996 amendments. Computerized credit scores are contained in huge national databases today. Credit scoring and application scoring technologies play significant roles in a vast majority of the credit-granting decisions that are made.

Perhaps no area has changed greater than in mortgage lending. In less than a decade, mortgage loaning has gone from a largely manual decision-making process to an automated one. Predictably, fans of credit scoring say that it represents an improvement over manual underwriting, because it is more objective, it has a greater predictive value for judging which than does manual underwriting. The efficiencies that scoring provides permits expanded underwriting and has contributed to increases to homeownership overall and for increases in homeownership for the underserved.

They also say that scoring is fair and unbiased, but only the developers of these scoring systems know this for sure. Their confidence in the fairness of these systems must be accepted today as an article of faith, because these systems are very closely held and proprietary. Former President Reagan once said in another context, "Trust, but verify." And that is our position about assessing the accuracy and fairness of the scoring models that are used today.

Concerns about the fairness and accuracy have been raised almost since these new systems have gone into effect in the mortgage area, and the stakes are higher than ever before. No longer is it just about access to credit, meaning affecting people at the margins, but the advent of risk-based pricing, which is being used more and more in mortgage lending and other areas of consumer credit, means that scoring also affects how much credit costs and the terms and conditions that are extended. In other words, it affects virtually every consumer. Consumers that do not meet the minimum cutoffs that credit scoring assigns are relegated to the higher priced sub-prime market.

The concerns about the scoring models in place are several fold. Research, as Travis and others have suggested, indicate significant inaccuracies and inconsistencies in the underlying credit reports. This represents a double-whammy, in effect. If the reports are inaccurate, then it is likely the credit scoring models are, as well. The CFA study indicate that one out of five of households are at risk of being misclassified, as a result of these inaccuracies, into the sub-prime market.

But regulators have also voiced concerns that certain creditors may be manipulating credit reporting systems in an effort to hang on to what they view as their most favorable customers by not reporting favorable information about their coustomers.

There are also a host of methodological issues, including under representations of key demographic groups, such as low-income people and minorities, and important omitted variables from the credit scoring methodologies, such as non-traditional factors that may pertain to predictiveness: counting rent payments and utility payments, as examples.

And when pressed, all the purveyors of credit score models will acknowledge that minorities, African-Americans and Hispanics, are disproportionately adversely affected by the methodologies today in place. In other words, on average, minorities fare worse under credit-scoring methodologies than do white households.

This doesn't necessarily mean they are discriminatory. But given the legacy of lending discrimination and housing discrimination in this country, adverse impacts should be treated very seriously. And it should trigger very strict scrutiny, such as an effects test analysis, which would ensure that the factors and their weight are being used correctly in the models; second, that there is a business necessity for using these factors; and third, that less discriminatory approaches that would achieve the same ends are not available.

But despite these legitimate concerns, independent review and analysis has not been conducted to ensure the validity and the fairness of the scoring systems that are in common usage today. We urge, therefore, the establishment of an effective and meaningful oversight process, which would evaluate and regularly monitor the statistical scoring models that are used.

We think Federal agencies such as the FTC and HUD can be used for these purposes.

In conclusion, let me say such steps we believe are necessary to lift the veil of secrecy that exists. These steps are entirely consistent with the objectives of FCRA to ensure accurate credit reporting and are necessary in order to achieve full consumer confidence in credit decisions that are being made today.

Thank you, Mr. Chairman.

[The prepared statement of Allen Fishbein can be found on page 85 in the appendix.]

Chairman BACHUS. Thank you, Mr. Fishbein.

Mr. Gambill, before you testify, I want to say this to all members.

Mr. Gambill is CEO of one of the credit bureaus or credit reporting agencies.

And I want to commend you for testifying. Often, no matter where the fault may lie, it is directed at the credit reporting agency. You sometimes find yourself the whipping boy, even though someone may have supplied you with bad information or because someone is receiving a credit score that they don't like. So I think most of the members of this panel are knowledgeable of that fact and will bear that in mind during the questioning.

We welcome your testimony. And we also, I think that all the members of this panel realize the problems in the system, that we all work together. But I think we would all agree, including consumer groups, industry, et cetera, that credit reporting agencies are a valuable component of our lending and borrowing process and our economy, and perform a very fundamental role. So I thank you and welcome your testimony.

STATEMENT OF HARRY GAMBILL, CEO, TRANSUNION LLC

Mr. GAMBILL. Thank you very much, Chairman Bachus.

And thank you, Congressman Sanders, and members of the subcommittee for inviting me to be here today.

As you know, TransUnion is one of the nation's largest consumer credit information companies. We are a facilitator of commerce that provides credit granters with information and analytic tools that enable them to better understand their customers and make more informed decisions. And we provide consumers with choice, access, reliability and the promise of a robust and more stable economy. All of this relies on Federal preemption. Federal preemption brings uniformity to the risk management process that is inherent in the granting of credit.

Uniformity allows lenders to make fast, reliable business decisions on a national basis. Uniformity means consumers are treated equally and presented with a constantly evolving array of financial products and services uniquely tailored to meet their personal lifestyles and qualifications. Uniformity allows regulators to assess risk and take appropriate measures to protect the interest of depositors and the American public.

If Federal preemption were allowed to expire and each State, county or municipality are permitted to adopt their own laws, the credit reporting system will be severely fragmented, and the consequences to the consumer and our economy will be significant.

We have seen this play out in other markets around the world. In many countries, consumers, regardless of their credit profiles, don't have access to long-term mortgages at all or must pay interest rates of more than 20 percent on the loans that they can get. This is the direct result of the lack of a comprehensive and uniform credit reporting system. Consumers in those countries really have few options. They are generally tied to one institution, their bank, for all of their financial needs.

There has been a good deal of discussion before this subcommittee on identity theft and data accuracy issues. These concerns are not taken lightly by TransUnion, but should not override a law that, and I quote from legislative history, "recognizes the fact that credit reporting and credit granting are, in many aspects, national in scope, and that a single set of Federal rules promotes operational efficiency for industry and competitive prices for consumers."

To address the concerns of identity theft and data accuracy, I believe we start with consumer education. Consumers are more engaged in the credit reporting process today than ever before. We believe the public and private sector must each take a role in ensuring consumers know their rights under the FCRA. And TransUnion has responded to the need for consumer education by making tools available that help individuals manage their financial help. We are committed to providing education to consumers through a multitude of channels, but our ability to do that, if we first have to find out their address, will be severely limited.

We make our living by accurately and efficiently processing 2 billion pieces of information into 192 million credit files every month, and we do it well. We recognize, however, that some consumers have questions and issues regarding the information in that file.

And that is why we have recently made large investments in technological platforms to automate the re-verification of information. Fifty-two percent of our data providers now participate in the automated process of re-verification, and our goal is 100 percent participation.

We believe this approach will seamlessly resolve most matters quickly and efficiently, but we face a significant challenge from credit repair clinics. If these credit repair clinics are allowed to continue to generate spurious volumes, and they are currently responsible for 35 percent of our total re-verification volume, our ability to deliver fast, accurate resolutions will be hamstrung.

That will bring us to identity theft. We understand the personal nature of an individual's credit information, and have taken substantial steps to protect the integrity of our systems and our information. We are strongly committed to continue to be part of the identity theft solution.

TransUnion led the industry with the creation of a fraud victim assistance center, which has been recognized by law enforcement, as well as the media, for its unprecedented service to identity theft and other credit fraud victims. Our fraud victim assistance experts work with consumers, law enforcement and credit granters to assist victims and aid in the apprehension of perpetrators.

Earlier this year, TransUnion and our competitors announced that we now share information related to fraud identity theft victims. Consumers can now make one call to any of the three national bureaus and be confident that all of us will put the appropriate safeguards in place.

U.S. lenders are purchasing millions of credit reports each day. These reports allow lenders to make decisions that allow consumers to enjoy same-day commitments on home loans, receive instant credit approval at the retail point of purchase and drive off a car lot with the vehicle of their choice in minutes. Lenders are making those decisions based primarily on the information contained in a credit report, because the credit report system works.

This system is critical to our economy. Our economy is driven two-thirds by consumer purchasing, and we believe our system must be maintained.

Thank you again for the opportunity to be here. We at TransUnion are committed to assisting your committee in any way that we can with respect to this important matter.

[The prepared statement of Harry Gambill can be found on page 94 in the appendix.]

Chairman BACHUS. Thank you, Mr. Gambill.

At this time, we are going to have questions from the members of the committee, and I am actually going to waive my questions. I will say that I am sure that Mr. Sanders or someone else will ask, particularly Mr. Gambill, about free credit reports. That is something we are hearing a lot about.

And if that question is asked, I would like you to detail the impact that will have, you know, on your company. I think if we discuss that, we need to know about the impact of it.

Mr. Feeney has no questions.

Mr. Hensarling?

Mr. HENSARLING. Thank you, Mr. Chairman.

There appear to be some accusations of huge inaccuracies within our credit reporting system. So I guess, Mr. Gambill, my first question would be for you. Can you quantify for me the number of credit records or reports you are responsible for and how often consumers have complained about inaccuracies? How often have records been changed because of inaccuracies in the report?

Mr. GAMBILL. I will give you some of the information, and I would like to have my team be able to work with individually so I can really understand your question.

About 8 million consumers a year avail themselves of the opportunity to get a free credit report from TransUnion. That represents probably about 8 percent of the households in the United States. About half of the consumers that then get a copy of their credit file ask us to re-verify something on it, either because they don't understand it or they may disagree with the rating as provided by one of our data furnishers.

So, the 8 million people, which represents about 2 percent of the files sold, on who we sell files ask us for copies of those in a free manner. Then, about half of those ask us to re-verify something on those files. The average file has about nine trades on it, so now I am getting into math. I had better stop trying to do and have the team work with you on it individual basis.

But 2 percent of the people ask for a copy and then half of those ask us to reverify something.

Mr. HENSARLING. Thank you, that is helpful to me. When I hear about accusations of huge inaccuracies within the system, I am a firm believer that the world works off of incentives. I am trying to figure out who might have an incentive to put inaccurate information into the system in the first place. I am somewhat curious.

I guess my next question would be for Mr. Courson and Mr. Moskowitz, since you both are in the business of extending credit. I assume that to be profitable you would like to make more credit transactions instead of fewer. And to make more transactions, you need accurate information so that you can price the risk premium accordingly. And if that assumption is true, in your observation, who has an incentive to put inaccurate information into this system?

Mr. MOSKOWITZ. I don't think any lender has an incentive to put inaccurate information into this system, including lenders that would like to retain their existing customers. Each lender has a vested interest in the performance of the loan and the success of the consumer who has the loan. And the integrity of that system and the quality of that information is the necessary foundation of that.

If we merely were interested in retaining our own customers, or a lender was merely interested in retaining its own customers, you could argue that. But a company like Wells Fargo has a much larger interest in expanding its customer base and relies on the integrity of the information in the system.

Also, to protect itself from identity theft and from fraud, it relies on the information, corrects erroneous information promptly and would assume that all lenders in that position who have integrity would do the same thing.

Mr. HENSARLING. Mr. Courson?

Mr. COURSON. Our members, obviously, are primarily originating and selling loans, Congressman, into the secondary market, so we have another standard that we have to meet in terms of standing behind the information we have. And there is really, as Mr. Moskowitz says, no incentive for incurate consumer credit reporting.

As a matter of fact, lenders are the ones that are standing behind the loan based on the accuracy of the information that we receive. Lenders are both users and furnishers of information provided through the CRAs as we make our credit decisions.

Mr. HENSARLING. Given that my time is rapidly running out, I would like to ask each of you to just give the briefest of answer to this question. If we did not reauthorize the Fair Credit Reporting Act, would there be more credit offerings or fewer credit offerings to the American people? Would the credit be more expensive or less expensive? Just from left to right.

Mr. COURSON. There clearly would be less credit offerings, particularly because you have to deal with a patchwork of 50 different sets of State laws. Clearly, we have a national mortgage market. The easy and fluid movement of capital across State lines exists because of the seamless ability of mortgage lenders to obtain credit information, make credit decisions and offer products. If Congress starts putting barriers up, and we have to deal with 50 different standards, obviously, some lenders will withdraw, some will not compete, there will be less markets available and, therefore, a higher cost to the consumer.

Mr. MOSKOWITZ. And I would follow up that comment by saying that the current national standard that we have allows lenders like Wells Fargo to make credit more available by innovating products that identify the needs of communities, low-to moderate-income communities, and that the failure to extend FCRA would limit those opportunities because of the impact on liquidity in the marketplace.

Mr. PICKEL. Since we sell to both the companies that MBA represents and Wells Fargo and others like it, we feel like it would increase the cost quite substantially. As a further comment, we feel like it would increase the cost, especially in rural areas, where credit may not be extended as much as often where mortgage brokers really excel, and also when you have a city that is on a State line if the States enact different laws.

Thank you.

Mr. PLUNKETT. As we heard last week, we have a national mortgage and lending market created through joint State and Federal regulation. The Fair Credit Reporting Act is not expiring; some very limited provisions are expiring. If minimal baseline meaningful Federal standards were on the books, you would get a lot of uniformity. And States like Vermont could respond to localized problems and help their citizens after, then Congress would be able to respond.

So I don't see, if that approach were taken, which is the approach we are recommending, I don't see a change in lending at all.

Mr. FISHBEIN. I would agree with Travis on that. I think if we allow the States to be more active players in this process, that could very well improve the level and accuracy of reporting.

Mr. GAMBILL. To try to directly answer your question, there would be more offers to apply for credit, because absent the prescreening preemption provisions of FCRA, lenders would still have to find new cardholders, but they couldn't target their mailings. So, they would have to broad scale mailings to people offering the opportunity for them to apply without having those mailings be pre-approved.

Consumers would then apply, and the turn down rates would go up, of course, because they will have gone to everybody, not only those people that already meet the eligibility standards. So, the ultimate result would be higher costs, probably same amount.

Chairman BACHUS. Okay.

Thank you, Mr. Hensarling.

Mr. Sanders?

Mr. SANDERS. Thank you, Mr. Chairman.

Representatives of the industry have argued that they want to preempt States from passing strong consumer protection legislation. Just to set the record straight, because I hear a lot about concerns about consumer needs today, let's be clear that every major consumer organization in America, including the two that are represented at the panel right now, but U.S. PIRG, Consumer Federation of America, Consumers Union, National Consumers Law Center disagree with industry.

And they believe, as I believe, and I think many, Americans believe, that what we want are high national standards to protect consumers, but we want to allow States to go even further so that they can address their own local needs and become laboratories for democracy.

Second point that I want to make is that in a recent study, Consumers Federation of America examined over 500,000 credit bureau files. And they found, among other things, that 29 percent of the people whose reports that they examined had a range of 50 points or more between the highest and lowest scores. One in 25 of the people whose reports they examined had a range of 100 points or more between the highest and lowest scores.

As everybody here understands, that makes all the difference in the world between whether somebody's going to get reasonable interest rates or very, very high interest rates.

Now, given that reality, what I would like to ask is representatives of the industry, and perhaps everybody on the panel, but we will start with Mr. Gambill. Given that reality, do you think that these errors could be reduced by allowing consumers to receive free credit reports and free credit scores at least once a year?

In other words, wouldn't the consumer at least have a fighting chance to know why his or her interest rates are escalating, perhaps because of false information, if they, in fact, had a report in their hands?

Why don't we start with Mr. Gambill?

Chairman BACHUS. Without taking the gentleman's time, I mean, just extending your time, you said "errors." You mean differences in scores?

Mr. SANDERS. Well, I mean that when you have three separate companies coming up with three separate ratings, somebody is making a mistake. "Errors" is the word I would use.

Mr. Gambill?

Mr. GAMBILL. Yes, sir. I think I heard a question about free reports, Congressman, and also a question about accuracy.

Mr. SANDERS. Free reports and free credit scores so consumers could know what is going on in their lives and why they may be paying higher interest rates than they should be paying.

Mr. GAMBILL. Yes sir. Thank you.

You know, when people ask me in my job, What keeps you up at night? one of the things that keeps me up at night is, how in the world will we do it? If Congress decides to pass a law that says that we need to give away credit reports to consumers with 200 million of them likely to ask, here in America, existing law provides free reports to people who have been declined for credit; who are unemployed; who are on welfare; who are or think they have been victims of fraud; or who are or are likely to be seeking employment.

In our case at TransUnion, that represents about 8 percent of the households in America. But we know that that is a relatively consistent percentage of the volume of reports that we sell. And we know how to manage a business and manage our support functions to deal with those 8 million reports or so that we are going to provide on an annual basis.

I don't know how to build a business around the fact that there might be a front page article on USA Today tomorrow suggesting everybody that reads USA Today is now eligible for a free credit report, and they should call.

Mr. SANDERS. Well, my time is limited, and I am gathering that you think that this is not a good idea?

Mr. GAMBILL. Yes sir.

Mr. SANDERS. Okay.

Mr. Plunkett, what do you think? Do you think consumers should have a right to know how their interest rates are determined?

Mr. PLUNKETT. We think it is the best and least expensive way. As Assistant Secretary of Treasury Abernathy said a few weeks ago, Imagine tens of millions of Americans having easy, free access to their credit reports. They can prevent these problems before they occur. It is the most cost effective way to do it.

And in speaking about costs, we need to talk more about cost to consumers if we don't act, not just cost to business if we do act.

Mr. SANDERS. Okay.

Mr. Courson, do you want to give us a view on that?

Mr. COURSON. Mr. Sanders, obviously mortgage lenders are also users of consumer information. I really feel that we are not the appropriate party, however, to respond. As to whether access to credit reports should be free.

Mr. SANDERS. Mr. Moskowitz?

Mr. MOSKOWITZ. As we said, we have a vested interest in the accuracy of the information. And an informed consumer who understands the ramifications of their credit and their performance and their life and how they manage their credit is a benefit to that consumer, and ultimately will increase the likelihood that they will become a homeowner.

Mr. SANDERS. So, do you support the right of consumers to get free——

Mr. MOSKOWITZ. I can't comment on whether or not it should be free or not, but availability and knowledge of what is in your credit report is a good thing.

Mr. SANDERS. Mr. Pickel?

Mr. PICKEL. Well, like Mr. Moskowitz, I don't think I can comment on whether or not it should be free. But I do want the credit reports to be accurate. And I will tell you, sir, as a mortgage loan officer working with consumers, oftentimes it takes a lot of time to work with a consumer on a credit report. It is somewhat intimidating, it is hard to read, I am not sure if they just got it, it would help. But that is not for me; we want it to be accurate, and we want them to get home loans.

Mr. SANDERS. Mr. Fishbein?

Mr. FISHBEIN. I agree that the disclosure ought to be regular and be free for credit reports and scores. I think the industry should actually be promoting this as much as possible——

Mr. SANDERS. Right.

Mr. FISHBEIN.——in an effort to try to correct the complaints about inaccuracies and inconsistencies. The best way to do that is by providing people with more information.

Mr. SANDERS. Who is going to know about their credit history better than the consumer himself?

Mr. FISHBEIN. Correct.

Mr. SANDERS. Okay.

Thank you all very, very much.

Thank you, Mr. Chairman.

Chairman BACHUS. Thank you.

Mr. Fishbein?

I will ask a question now.

One of my staffers was recently burglarized. You know, they stole his TV and they stole a stereo system. And he went down to the D.C. police department and asked for an incident report on that, and he was charged $10 for it. Do you think he should have been given a free police report?

Mr. FISHBEIN. Well, I don't know whether we want to use the standards of the D.C. police department for judging access to credit reports.

Chairman BACHUS. I mean, do you think that was fair that they charged him for that report?

Mr. FISHBEIN. We hear a lot of talk about new technologies and cheaper and faster. Technologies have a tremendous ability to provide people with information relatively inexpensively. And I think that ought to be pursued very carefully by the industry in an effort to get more——

Chairman BACHUS. But you didn't answer my question. I mean, we are talking about free reports; do you think they should have given him a free report? I mean, he pays taxes, you know, he actually pays the city of D.C. Should he have been given free reports?

Mr. FISHBEIN. Well, if the D.C. government had a way of providing this information inexpensively, then I think it could be done. Again, I think we don't want to use that measure. What we are talking about here is——

Chairman BACHUS. But you understand what I am saying. They charge money for this report, and actually, he pays taxes to D.C. And actually, as taxpayers, we don't pay taxes to TransUnion.

Mr. SANDERS. Mr. Chairman, I would agree with you. You are absolutely right. Perhaps he should have been given a free report, and maybe if they had Statehood and collect revenues, they would be able to do it. But——

[Laughter.]

Chairman BACHUS. Well, actually, I was charged $5 for somebody who ran into my car in Alabama. I was charged $5 for an accident report. I didn't demand any. I guess we could give everybody everything free, but who would pay for the cost of maintaining these systems. The cost would go up, wouldn't it, I mean, if they are giving away 20 million free reports?

And I guess as a practical matter, I am just wondering if all of this was available and free and you could get it for free, why would anybody pay them for a report? How would they make any money? And wouldn't they just go out of business?

Mr. PLUNKETT. Mr. Chairman?

Chairman BACHUS. I mean, if you give away your product, how do you stay in business? I guess that might be my question. And I am asking the two consumer people. I mean, how do you get around that?

Mr. PLUNKETT. Well, revenues for the credit reporting agencies has certainly increased in terms of their direct sales to consumers. But as the bulk of their revenue is generated through the users of the system, the furnishers and those who use the system for risk analysis and other purposes. However, we have seen a growth in premium services that are charging consumers for some items that we think are vital and should be free, like the credit score or——

Chairman BACHUS. Well, now, you are——

Mr. PLUNKETT.——credit reporting information.

Chairman BACHUS. Aren't you charged for a lot of services that are vital today?

Mr. PLUNKETT. I would agree with Representative Sanders that certain government documents are so important, such as a police report, such that they should endeavor to give you those documents as cheaply as possible. In this case, consumers are the subject of these documents. They have an absolute right to ensure that the information about them is accurate. And the best way to do that is to make access easy through free reports. Six States require this already.

Chairman BACHUS. Well, you know, I was just looking, I had a list of when you get a free credit report. Today, current law says that credit bureau has to give a free report to people on public assistance, people seeking employment, people denied credit, people denied insurance, people denied employment, people that think they may be the victim of identity theft. And everybody else pays $9. In other words, if you can afford it, you pay for it.

And I am not talking about accuracy or anything else. I am talking about that it is at great expense that they maintain these systems. I mean, they are a for-profit corporation. And I don't think that there is anything wrong with that.

Mr. SANDERS. Mr. Chairman, could I——

Chairman BACHUS. And, you know, if we wanted to start a public agency to maintain records, or something, but I am just wondering even almost the constitutional implications of starting to tell people to give away their product. Does that bother you a little bit from a constitutional standpoint?

Mr. PLUNKETT. I haven't heard, Mr. Chairman, of any constitutional issues being raised regarding the six States that require it now. Overall, it decreases cost in the system, and in many ways makes the system more effective for lenders. If the information is more accurate, they can predict risks more accurately. If consumers correct errors, the lenders have a better system, as well. Overall, I see it as a win-win.

Chairman BACHUS. Okay. All right. Thanks.

Mr. Gambill, do you want to respond?

Mr. GAMBILL. Well, yes, sir. Thank you.

At $9, providing reports to consumer that want it is not a moneymaker. Okay? If it was, you would see us advertising it a lot more heavily than we do now. Our companies aren't that big. The credit reporting companies in America in information services are well under $1 billion in sales. We spend, already, probably 10 percentish of our money dealing with this population of consumers, that we are happy to deal with and help, that are entitled to free credit reports.

So it represents a huge change if we are to go from disclosing 8 million reports a year to disclosing a 100 million, or 200 million.

And as I said, I just don't know how we will do it. I am sure that we will, if we are somehow required to, but I don't know how we will plan for it. And I don't know how we will be able to continue to give the kind of service and automation investment in reverification issues for consumers that are entitled to free disclosures if we have everybody that is responding to e-mails that may go out. There was a recent e-mail that had millions of people opt out unnecessarily. It cost us $2 million at TransUnion just to deal with that kind of thing. I don't know how to mange it.

Chairman BACHUS. Let me say this, we have a vote on the floor. We are going to recess this hearing until the end of vote, and it probably will be at least 30 minutes.

I do want to say this in closing, we have talked about the difference between the report at the credit bureaus, the difference in credit scores. And we have talked about that as an error. But, you know, conservative groups give us a score, you know, and liberal groups give us a score, and I may get a 95 from one conservative group and a 90 from another group. He may get a 2 from one conservative group. And a five from another. But that wouldn't be an error.

I mean, that would be each group using a little different criteria. And I don't call these groups and say, You have made an error. This other group scored me at an 85, you scored me at a 10. There is a 75 percent discrepancy here. I mean, they are using different input. And, I mean, this is proprietary.

This is the most popular thing that both sides of the people talking about free credit reports, I just think somebody has got to pay for it. If you ask these credit reporting agencies to pay for it, and it costs 50 percent of their revenues, that is a problem. I mean, that is almost confiscation of property.

We will recess this hearing at this time.

[Recess.]

Chairman BACHUS. The subcommittee will come to order.

The gentleman from North Carolina, Mr. Watt, is recognized.

Mr. WATT. Thank you, Mr. Chairman.

It is a good way to slip back in and cut the line before everybody else gets back. So I am glad to be able to do that because I have to go to the floor and do something on this class action bill.

This is the third set of hearings we have had on fair credit reporting. And I have been trying to get to as many of the panels as I can to see whether there was any kind of consensus starting to be built about some things that we might begin to coalesce around. And I wanted to try to see, maybe, whether some consensus is beginning to emerge on at least some principles that we could start to draft a bill around.

Mr. Plunkett, your testimony may be interpreted by some to suggest that you are disenchanted with a Federal standard. But it seems to me that most of the things that you raised questions about would probably be worse off if we didn't have a Federal standard, at least in some areas of the country they would be worse off. In some areas of the country they might be better off.

So I guess the question I want to ask you before I start to try to see whether there is any consensus is whether you are advocating for no Federal standards? I don't think that is what you are doing, but I want to clarify and be clear on what it is you are advocating for.

Mr. PLUNKETT. We propose strong Federal baseline standards. We have also endorsed the notion that the existing eight preemptions should be allowed to expire and then where States deem it necessary, they could exceed, not conflict with, but exceed the strong Federal baseline standards.

Mr. WATT. So you are not advocating for expiration necessarily, maybe improvement of the existing standards with that being the base, rather than—and then States could go beyond that? Would that be a fair characterization of what you are——

Mr. PLUNKETT. Absolutely, Congressman. And in that circumstance, it would be very rare and quite unlikely, especially initially, that States would choose.

Mr. WATT. But, I mean, is it clear to you that the kinds of things that are covered in the eight standards that exist, whether they are the correct minimum Federal standards, but the kinds of things that are addressed in those eight standards should be the kinds of things that you would set a minimum Federal standard for?

Mr. PLUNKETT. Absolutely.

Mr. WATT. Okay.

And now, Mr. Courson and Mr. Moskowitz, I take it, and Mr. Pickel, also, I guess, all of you agree that there needs to be Federal standards, I take it?

Now I guess, ideally, if you had a Federal standard, and the standard was good enough nationwide, we wouldn't have to worry about States preempting or States passing something even more aggressive.

How would you all react to the existing eight things being massaged and clarified in some way and maybe trying to get to some consensus on the things that I have heard really most people complain about? Those are errors and accuracy; credit scoring; dispute resolution; maybe free credit reports, if some consensus could emerge on that; discrimination or adverse impacts on minorities; and identity theft.

Do you all think that those are the kinds of things that there ought to be some Federal standard for, I guess?

And I am assuming you all were probably for the Federal standards whenever this thing was done 15 years ago. But now you have decided it is a good idea to have that Federal standard. Are those kinds of things the things that we also should have some minimum Federal standard on?

Mr. COURSON. Congressman, as you know, you are correct in saying the uniform national standard fo consumer credit information credit the free flow of capital across State lines. Mortgage lenders are very concerned that their ability to originate loans across State lines with consistent standards will be in jeopardy if the preemptions disappear. The preemptions were put in place in 1996, and as a result, mortgage lenders are doing increasing volumes of business, both purchase and refinance. The system is working. Mortgage lender flow enable credit to move back and forth, across State lines.

My concern is that once Congress gives States the opportunity it will block the free flow of credit requirements among States. My fear is, as we have seen in other areas.

Mr. WATT. I understand that, but would you accept the proposition that on the things that I have just described, the list of things, that there ought to be some Federal standard?

Mr. COURSON. Well, I think you have to look at each of these areas on an individual basis. We are talking about the FCRA including the preemptions that target to some very specific areas. There are other issues that have been discussed today, and our concern is that we don't want to disadvantage the consumers by not maintaining the preemptions so that we can continue to have free flow of credit.

There are other issues to discuss, but I think that we have to realize, too, that the FCRA basically deals with those specific seven items.

Mr. WATT. You mean there is something on my list that should be discussed outside of fair credit reporting? I mean, it seems to me that all of those things are being impacted by fair credit reporting.

Mr. COURSON. Some of them would affect our industry, and others on the panel, also.

Mr. WATT. I know I am over my time, but it would great if I could hear from Mr. Pickel and Mr. Moskowitz.

Mr. MOSKOWITZ. I would echo what Mr. Courson said. The concept of uniform, understood Federal standards that ensure consistency in decision-making is obvious to us. And the ability of a myriad of State regulations overlying those standards would actually undermine the effectiveness of those standards and would ultimately impact liquidity and availability of credit, in general. So we would not be in support of that.

Mr. PICKEL. NAMB has not taken a position on identity theft. But that said, we really want the credit reports to be as accurate as possible, and if it is a Federal standard on those issues that you brought up, it would seem like to me that would be better than individual standards by State on those issues, sir.

Mr. WATT. Thank you, Mr. Chairman.

Chairman BACHUS. Thank you, Mr. Watt.

The gentleman from Illinois, Mr. Gutierrez?

Mr. GUTIERREZ. Thank you, Mr. Chairman.

Mr. Gambill, what is the total profit of your corporation for the issuance of credit reports? That is, when private individuals ask you for a credit report, what is the extent of that? Is it 2 percent, 5 percent?

Mr. GAMBILL. Well, we almost have no revenue from that particular source at this point, Congressman. And right now it is underwater. We were trying to build a business there. We acquired a company to help us do online disclosures in a more efficient way. But we are at below break-even at this point on the sale of reports directly to consumers. I would like to see that ultimately become something in the 15——

Mr. GUTIERREZ. Why are you losing money on that particular part of your business?

Mr. GAMBILL. Well, I am just trying to build my sales. I am trying to build the consumer base that uses the products and services that we have available. And we have a level of cost right now that is greater than our sales. Our sales are about $30 million in that space, and so are our costs.

Mr. GUTIERREZ. So where do you derive most of your profits, then?

Mr. GAMBILL. From the sale of credit reports to lenders.

Mr. GUTIERREZ. To lenders?

Mr. GAMBILL. Yes, sir.

Mr. GUTIERREZ. I was just curious about where you derived most of your profits from, because I know that everyone else, kind of, was speaking about issuance of credit reports and their availability to the public. And I guess it is the nature of your relationship with the public that I think is different. And that is that you gather information on me and everyone else in this room. You don't ask me if you can use that information, but yet you sell, you barter and you use that information to say, as you say, that makes the majority of your profit in your corporation.

So I think it is different than when I go down and, I don't know, get a birth certificate from someone, and say I need a birth certificate because I had to enroll my daughter in school, and I need a birth certificate to get that, in that you are in the business of gathering my information, selling my information. And I think you have a responsibility with me and everyone else whose information you are using in order to generate profit for your corporation. So I think in that sense it is a very different relationship than other kinds of relationships that have been expressed here today.

So I would just like to see how this committee could take that very special relationship that not only Mr. Gambill who is here and was kind enough to come before this committee, not expecting to get a very pleasant reception here today. He knew he was going to have to answer some hard questions today about how it is you do it.

But, yes, they should make a profit. And I think government has to protect the right of the people that send us here, the consumers, and what the relationship between Mr. Gambill's corporation or any of the other two major corporations that issue credit information that is garnered for the public to make sure that it is the best information available, and they can correct that information. Because, as Mr. Gambill has testified, he makes most of his profit, because he loses money on the other part, from one area, and that is selling the information.

So when I walk into a department store and they say, you know, we will give you 20 percent off if you take this credit card, he makes some money. Because they call and say, Mr. Gutierrez would like this credit card, get his 20 percent off. And that is where he makes his money. And I want to make sure that I don't have any problems. I get my credit card, I get my 20 percent off.

And that is really not a very, very serious issue, whether I am going to get 20 percent off on a tie or a shirt or something I might purchase that maybe I really don't need. But when it comes to my home.

And I think, Mr. Chairman, that we have found, and I think this could be proven in one study after the other, that there are problems, problems that range from 10 to 20 to 25 percent of errors that exist on these credit reports that the credit agencies have taken from the public to make a profit from.

So I think they have a responsibility with the public. I am sure they don't want to shirk that responsibility with the public. And I think we have a responsibility. We regulate how much I pay for my telephone bill, how much I pay for my gas. As a matter of fact, the price of my milk has a relationship with actions in the Congress of the United States, even when I buy my Snickers bar, since we subsidize peanuts, or sugar and everything else in this Congress.

So the Congress has taken action in order to avail the public of the best possible avenue. And since we do have Freddie Mac and Fannie Mae, and we take on issues, and we have a huge institutional responsibility to guarantee that people, and we have mortgage insurance for those, I mean, we are in the business of helping people in homeownership. And it seems to me that if we just look at it, not so much vis-a-vis the corporations and what their profit—they should make a profit, I agree with that—what is our responsibility to, kind of, blend in all the other actions we are taking to guarantee homeownership, which we know is a key critical point of our economy, that we do that?

And lastly, Mr. Chairman, I hope that at some point, since it has now been it is a fact, that insurance and what I pay for insurance, which makes up part of my monthly payment when I go to a bank and they say, Oh, Mr. Gutierrez, you are going to pay PMI, and you are going to pay this for taxes and you are going pay this for insurance, since insurance is also now being driven by what is on a credit report, although I don't understand if I made a late payment what that has to do with lightning striking my house——

[Laughter.]

——but seriously, that does happen. It is a fact that we also look and expand as the insurance corporations now have gotten into using the credit bureau in terms of determining what a person will pay for insurance, because that could mean a lot of difference in someone's home ownership.

Thank you, Mr. Chairman.

And I want to thank all of the panelists for coming here today. They have been very, very informative.

Chairman BACHUS. I appreciate it, Mr. Gutierrez,

I would just, if you will yield for an additional minute, I would simply say that I don't disagree with what you are saying.

I think that I would point out that the information the credit reporting agencies are getting is not actually by going through our records, it is people that are furnishing those records. We do business with someone and that party supplies to them our record of payment or our credit relationship with the people that they are in association with. And then they actually share it, not with the general public, but they share it with people who we go to, like you say, where we go to someone and ask for, How about, you know, a $10,000 loan or a $200,000 mortgage? Then they share it with that person. They are not putting it out in the public domain.

But I think that you are asking and thinking, I mean, we are all asking these questions, and that is the way we get a decision-making.

The gentlemen from Ohio?

Mr. TIBERI. Thank you, Mr. Chairman.

Chairman BACHUS. Mr. Tiberi?

Mr. TIBERI. Mr. Gambill, let me direct a question to you, at least, let me give you my bias up front. I believe we should extend, permanently, FCRA and I have introduced a bill with Representative Lucas. Not only to do that, but also to create a uniform standard with respect to privacy. And I have seen, as a realtor, before I came to Congress, the incredible result that the amendments to FCRA had with respect to consumer credit in Ohio, in central Ohio, where I was a realtor.

Now, put on your prognosticator hat, if you can, and tell me what you think would happen if my State legislature, and I was a State legislator, in the chairman's State legislature. And the ranking members State legislature, in Vermont, created three different types of standards that could happen if we don't extend FCRA, the amendments to FCRA. What would happen in terms of your role as a person who is obviously very much in the middle of the whole credit scoring issue?

Mr. GAMBILL. Congressman, we would have to invest in and develop significant new technologies to ensure that we complied with whatever the rules were relative to a consumer who was either seeking credit in Ohio, but had lived in Vermont, or was seeking credit in Vermont, but had lived in Ohio, or was seeking credit in Vermont or Ohio, but the credit grantor was in Delaware or South Dakota, to be sure that we understood how all of those rules interacted together.

Mr. TIBERI. And that would cost how much?

Mr. GAMBILL. Oh, a couple of million dollars per time.

Mr. TIBERI. And that would come from the Federal government, you assume?

Mr. GAMBILL. No, sir, I am assuming that I would try to extract that from my customers——

Mr. TIBERI. Okay. And your customers——

Mr. GAMBILL.——who use the information, who then are going to try to extract that from their customers.

Mr. TIBERI. So someone is ultimately going to pay for it?

Mr. GAMBILL. Yes.

Mr. TIBERI. And what may end happening is that that first-time homebuyer may actually end up not being able to qualify for a first home because of increased cost to their mortgage.

Mr. GAMBILL. Right. If a lender's costs go up, they either have to lend to less risky people, or charge more to the people they lend to.

Mr. TIBERI. Mr. Courson. Did I say that right?

Mr. COURSON. Correct.

Mr. TIBERI. Can you comment on that, as far as the lending industry?

Mr. COURSON. Sure. Well, unfortunately, I have been around this business long enough; I have seen how it works without this. The issue of trying to get a borrower's credit history who has lived in other areas is a nightmare. It is slow, it is debilitating and very costly.

And the gentleman's correct that, in fact, the cost of trying to put this together, somebody is going to ultimately pay, and it is going to be the consumer.

Mr. TIBERI. Thank you.

Mr. Moskowitz? Your testimony was very good. Let me ask you to expand on it, if you would, from a Wells Fargo perspective. And that is, and you may not be familiar with my legislation with Mr. Lucas, but taking the FCRA point one step further, how would a national standard on privacy impact Wells Fargo, and then ultimately, the person who has a loan with Wells Fargo, if we go ahead and take that step and do it?

Mr. MOSKOWITZ. Obviously, we believe that in a multi-jurisdictional company like ours, the ability to have a national standard, one which provides clarity to consumers, consistency and understanding of what the treatment of their information will be, is something that we think is advantageous.

With respect to the issues raised about various jurisdictions creating their own separate myriad of local, county and State-level requirements, we operate in multiple States. We have customers who have accounts in one State and live in a different State. Conflicting requirements would severely impact the liquidity of the marketplaces that we do business in.

So for example, mortgages that have to comply with various standards would be more difficult to securitize, would impact the interest rate scenarios that are available now, and would ultimately impact consumers' ability to get credit.

Mr. TIBERI. This is the final thought, Mr. Chairman. So correct me if I am wrong: Whether it is with respect to credit, whether it is with respect to privacy, to a multi-jurisdictional company like Wells Fargo or any other company that may be in more than one

State, ultimately it is going to cost you more money to deal with those different State requirements, and that will eventually be passed on to your customer. Is that correct?

Mr. MOSKOWITZ. That is right. The current system is a model of efficiency in that it allows, in particular, an operating subsidiary of a national bank the ability to efficiently drive down costs, serve customers, have consistency and clarity in a way that we have never seen before.

Mr. TIBERI. Thank you.

Chairman BACHUS. Thank you.

The gentlelady from New York, Miss Maloney?

Mrs. MALONEY. I thank the chairman very much for yielding.

And I would just like to State that despite the controversies of this week, I think we have to remember that the U.S. mortgage market is the best in the world, and the fact that home ownership is at 68 percent in this country is truly an incredible success. A major contributor to the high percentage is the ease with which consumers can now get approval for mortgages, because of advances in technology, including automated underwriting that relies on the FCRA.

Mortgage decisions are now made at speeds that would have astonished people trying to buy a home just a year or two ago. The ease with which people can be approved for a mortgage is one of the major factors that has kept the economic slowdown of the last 3 years from getting any worse.

As we all know, in the current low interest rate environment, mortgages are being refinanced at record rates, and this would be impossible without automation and readily available credit histories. And, Alan Greenspan has testified before this committee several times that it has truly been the mortgage market, the refinancing, that has helped our economic situation in this country.

The Washington Post detailed the impact that the ability to refinance so easily is having on the economy last Sunday in an article that I would request unanimous consent to place into the record. But to summarize——

[The following information can be found on page 215 in the appendix.]

Chairman BACHUS. Without objection.

Mrs. MALONEY. Thank you, Mr. Chairman.

To summarize it, it said that since 2001, banks will have processed more than 27 million mortgage refinances by the end of the year. Out of those, homeowners will have converted more than $270 billion of home equity into cash, either to spend or convert high interest debt into very low interest loans, at least another $20 billion that is freed up in lower monthly mortgage payments. And in total since 2001, refinancing will have delivered about $300 billion directly to consumers who will have more money to spend and pump up the economy.

That is in comparison to the $263 billion that the Bush tax cuts of 2001 and 2003 will have put back into the economy by year's end, which have less direct impact on spurring consumer spending, because they have gone not only to individuals, but also to businesses and in some cases, State and local governments.

So I do believe that there is a significant argument for the importance of FCRA and the health of the macro-economy in our nation.

At the same time, the reliance on automated underwriting magnifies mistakes in credit reports. This can be especially dramatic for individuals who are close to the line of being approved or denied a mortgage.

So my first question is to Mr. Plunkett.

The credit reporting agencies are in the business of selling reliable information to their clients. If their data is wrong, as your studies indicate, why does the lending industry continue to rely on them? And wouldn't incorrect data lead to losses for lenders and motivate them to find another means of monitoring and predicting whether people will default on loans?

Mr. Plunkett?

Mr. PLUNKETT. Well, the research shows, Congresswoman, that there are mistakes of omissions and mistakes of co-mission, omission being incomplete reporting. And the Controller of the Currency has commented on that issue. It is a good question. Why would furnishers shoot themselves in the foot, so to speak, by not submitting complete information?

And what the Controller said was that he thinks that some subprime lenders in particular are gaming the system by not including positive information about their borrowers, because they don't want their borrowers to be solicited by another lender, and they don't want to lose them, because their borrowers may find a better deal and go elsewhere. So that might explain a part of the incomplete problem.

Regarding the mistakes of co-mission, which we detail in our report, I don't think there is intent there to do harm: I think there is sloppiness. I think we have sloppy procedures, and we have a dispute system for consumers that doesn't work very well. So once a mistake is made, corrections are not made easily.

Mrs. MALONEY. Okay. Well, thank you.

Mr. Gambill, how do you respond to the findings of the Consumer Federation that credit reports contain widespread errors?

Mr. GAMBILL. Congresswoman, accuracy is how we make our living at TransUnion. We compete on the basis of the ability to have the freshest, most accurate, most complete file that is available to the lending community, so they can make the best, most useful decision about whether to lend money or develop a financial relationship, how much to charge for that and how to manage the overall relationship with the consumer.

There are going to be differences in files because we compete. There are going to be lenders who provide information to TransUnion and don't provide information to Equifax and vice versa, or there are going to be lenders who provide information to Experian and not to TransUnion, either because I haven't persuaded them to do so, haven't found out about them or there is something else going on between us and that particular lender that keeps one of us from putting their information in the file.

So certainly, our products do differ in the marketplace. If they weren't, if they were all alike, you wouldn't need but one of us.

Mrs. MALONEY. Could I briefly ask Mr. Courson and Mr. Pickel, in following up on this line of questioning, in your experience as a mortgage banker and broker, at your place in the loan process, do bankers ever question the information in credit reports? Do they question it, or do they just accept it?

Mr. COURSON. The credit information that we receive is really one part of a total underwriting. We are looking at the entire set of circumstances. And frankly, most of that information that we garner initially, as you know, Congresswoman, is from the applicant. So when we get that information from the applicant, what are their debts, where do they have credit, where have they had credit, we are able, then, to compare that to the records that we receive from third parties.

And if there is a discrepancy, it is really up to lenders, because we are the one making the loan, to reconcile those. And, in fact, we do resolve some of the disputes, if you will, or some of the questions as part of the process, because we need to know what is accurate before we put our credit and funds on the line.

Mrs. MALONEY. But so do the bankers work off the decisions that come from the automated underwriting process? Or is that just one part of a whole that they look at?

Mr. COURSON. Automated underwriting, which has as part of it, credit, and other factors are used for automated underwriting. It is utilized, in our case, at the outset of the process. If, in fact, the loan is approved, and gets an accept from and automated underwriting system, that loan is one that, in our office, and I think most offices, would go on to be made.

Sometimes, however, they are not. They will have a decision that is called a refer. In that case, what we do now is we go outside the system, we have to look at hard data and do further investigation to determine why, and then make a judgment, our underwriters make a judgment whether to make that loan or not.

Mrs. MALONEY. Okay. Thank you.

Chairman BACHUS. Thank you.

Mr. Sanders?

Mr. Sanders can take one minute.

And then, Ms. Hooley, you can have your full five minutes, or three minutes, or whatever.

Mr. SANDERS. Thank you very much, Mr. Chairman, and I will be brief and I appreciate you giving me the time.

Just a few basic points, number one, the name of our country is the United States—S-T-A-T-E-S—of America. And it is based on some brilliant work done by the founding fathers of this country, who created, if I may quote some of the panelists, a patchwork.

They said we should have a Federal government with certain rights, a State government with certain rights, local governments with certain rights.

Some of us, and I get disturbed with my conservative friends who seem to change their tune every other day whether they like the big, bad Federal government usurping the powers of the folks back home, or whether they don't, depending the issue in front of us.

I happen, as a former mayor of a city, to think that everything being equal, give the people backup, give the governance, give the State legislators the right to address the local problems if they can. That exists in a dozen different areas, and the word "patchwork" here is a misnomer. That is what America is about.

If we want to do away with States, we can have one nation, call it "America" and resolve the 50 State legislatures.

So I think States should have the right to protect consumers and not be preempted from doing that.

The second point that I want to make, the issue came up a moment ago about costs. My goodness, if Vermont or California does something that is going to raise up the costs, how are we going to pay for that? And Mr. Gambill suggests, well, it is going to be passed on to the poor old consumer.

Let me make another suggestion. According to Standard & Poor's, the top four executives of MBNA, who are the largest credit card dispensers in America, make close to $300 million a year. The top guy, the chairman and CEO, Mr. Lerner, makes $195 million.

Now, maybe they could pay for some of this consumer protection by lowering the outrageously high compensation packages that their top executive makes.

Third point that I would ask Mr. Gambill, a question. We have heard, unofficially, so I have to tell you its unofficial—I haven't seen it in print—that it costs, when you supply information to a large consumer of yours, a bank for example, it costs you 37 cents, or they pay you 37 cents for the consumer report and score. Is that roughly accurate?

Mr. GAMBILL. For a large issuer, Congressman?

Mr. SANDERS. Yes.

Mr. GAMBILL. Yes, sir.

Mr. SANDERS. All right. So when we are talking about making that available for millions and millions of Americans with Citibank, or these other big ones are paying, are 37 cents, approximately. I think the American people deserve the respect that providing these reports would bring them, and I don't think 37 cents is too much cost to provide that information.

Thank you.

Chairman BACHUS. Do you think maybe those top three CEO's ought to get a free report?

[Laughter.]

Mr. TIBERI. Mr. Chairman? Mr. Chairman? Mr. Chairman?

I just want to make note that one of those CEO's, Mr. Chairman and ranking member, passed away last year, Mr. Lerner. Just for the record.

Mr. SANDERS. I appreciate that.

Chairman BACHUS. Yes.

Ms. Hooley?

Mr. Meeks, Ms. Hooley, we yielded to Mr. Sanders, instead of Ms. Hooley, so if it is all right with both of you, Ms. Hooley, and then Mr. Meeks.

Ms. HOOLEY. Thank you, Mr. Chair.

There are so many questions, I don't know where to start. But I am going to start with Mr. Gambill.

And one of the things you said was if there was a free credit report, 200 million would likely ask for a free credit report. My question is where do you get the number? And isn't it true that in the six States where it is currently free there have been no increase in the requests? Can you help me verify that or not verify that?

Mr. GAMBILL. In the six States where it is currently free, there has been an increase in the requests.

Ms. HOOLEY. How much of an increase? Do you know?

Mr. GAMBILL. No, I could get my people back to your——

Ms. HOOLEY. Okay.

Mr. GAMBILL.——office with that data——

Ms. HOOLEY. Okay. I would like that.

Mr. GAMBILL.——and the very specific information because there are differences across each State as to what they need to do and why that works.

It is something more than doubled. And in using my "200 million," I just mentioned that there are 200 million adults, roughly, 195 million on whom we maintain files. And if there were big publicity spread across large pieces of news media, I don't know how many of them are going to request copies of their file. I don't know how to build an organization that could respond to the sudden influx of 1 million more, 10 million more or 7 million more that could result from a big e-mail campaign or a big piece of news publicity.

Ms. HOOLEY. Let me ask you a couple of questions. One of the things that I have been very interested in is identity theft and what that has cost all of us from the increase in cost for that.

We are looking at a way to do a couple of things. One is to make sure that individuals take some responsibility of what is on their credit report. And the second issue is, I mean, and it is been brought up several times today, it is how do we make sure those reports are accurate? I mean, I would hate to have somebody not be able to buy a house because the report was inaccurate or not be able to get a job. And I understand that before somebody is going to look at their credit report for employment purposes, that they have to tell them they are going to do that.

But if, you know, all of a sudden you see that report and there are some things on there that are not accurate that make your report look bad, I am guessing that an employer may say, Well, you know, it is going to take too long to clear this up, or provide some doubt.

So how do we do a better job in making sure that we have accurate reports? And then, and I just got my own; now, there is something on there that is inaccurate. I don't think it probably affects my score. But I made a point of every year getting mine because I have been involved in this. But how do you make sure that they are more accurate? And again, how do you make sure that people have the ability to take some responsibility for themselves on this? Many people have no idea where to get their credit report or what their credit report is even all about.

Mr. GAMBILL. Well, Congresswoman, the accuracy issue is an issue around which, as I said, we compete. There are probably 5 million credit reports a day, more or less, being purchased from either TransUnion or one of its two competitors in the United States today, and lending decisions are being made 5 million times a day based on those credit reports. Consumers that are adversely affected by the information in the file, so that they get either no loan or a loan at a higher rate than they had applied for, are notified where the report came from, they are notified what the principle factors were in the score that, if there was a score, that caused them not to get the loan and they are notified how to get their report for free from the supplier of that report.

We then, within the Fair Credit Reporting Act, upon receiving a request from them, are obligated to fulfill that request within a specified, regulated time frame, which we report to our regulating bodies on that, that we have accomplished.

Upon receipt of re-verification request, we now have automated systems in place so that we can, in fact, deliver to our issuers and lenders information that suggests consumers have asked us to re-verify a piece of information that is in their file. They can respond to us in an automated manner thus, decelerating the process dramatically and however they respond, we report back to the consumer what the results of that re-investigation were.

The consumer is also welcome to get a copy of a score. Scores are snapshots, they change constantly as the file changes and as information on the application that the consumer may have provided, changed.

Ms. HOOLEY. How do they get a score?

Mr. GAMBILL. When they get a disclosure, they are asked if they would like to have a score as well. They will get a score, as of that moment.

Ms. HOOLEY. You think there are some ways, for example, when they go to refinance their home or their automobile, or whatever they are refinancing, they are going for a loan the first time, do you think it would be an appropriate thing at the time to, when you are giving the information to the lender, that you provide a free credit report to the person that is asking for the loan? Does that seem reasonable?

Mr. GAMBILL. I don't know how doable it is. I would be glad to get a team to look at it under those circumstances and work with the committee on those kinds of ideas.

Ms. HOOLEY. Okay. I would like any ideas that you may have that, again, trying to make sure that individuals have some responsibility, and then trying to deal with the accuracies, are huge issues for me.

I have a question for Mr. Moskowitz. You mentioned in your testimony that there needs to be better notices and that should be part of the debate. Do you want to elaborate a little bit on what you mean by that?

Mr. MOSKOWITZ. Well, in our view, an informed consumer, a consumer who understands their credit file, the reasons for an adverse action is more likely, in the future to solve their credit problems and become a candidate to become a customer of ours.

On the side of privacy, a desire for consistency in disclosure is nationwide and adds to that same debate, so we have long advocated national standards for clear and consistent, understandable disclosures on both of those topics.

Ms. HOOLEY. What do we need to do to make those clear and understandable?

Mr. MOSKOWITZ. I think Congress needs to review and analyze the effectiveness of the disclosures that exist now, make improvements as necessary so that the information that is provided to consumers is understandable to them and is usable by them. And so for an example, in the context of adverse action, the reasons actually fit the reality and that the consumers then are armed with the information necessary to address any issues that they may have.

Mr. PLUNKETT. Congresswoman, we have a substantive suggestion on that if I——

Ms. HOOLEY. Okay. I am ready.

Mr. PLUNKETT. We have found in our research that we would agree here, that the reasons that are provided are very vague and don't go to the specific problem, the specific trade line, as it is called, that is creating the problem or trade line. When you get explanations as vague as, serious delinquency or derogatory public record or collection filed, that is too vague. We need more specific information on exactly which account is the problem, so that you can then act and see if there is an error.

Ms. HOOLEY. Do any of the credit reports come out—any of you can answer this—do any of the credit reports come out, have their score on it, what that score means? Do you know, any of you?

Mr. MOSKOWITZ. Well, I can comment on our ability to comply with California requirements that obligates Wells Fargo to describe or conclude in an adverse action notice, the requirements for basic drivers of a FICO score, and we provide that information. We have no evidence that that has actually added any value to consumers in addition to the value that is provided into generic action reason codes, or that consumers actually understand what that means.

We are strong advocates of informed consumers, educated consumers and consumers who can take information that they know of themselves to increase their likelihood to obtain credit.

Mr. PLUNKETT. I would respond by saying that if the information we are getting is that, yes, most people don't understand their credit score yet. But the first step is to provide them with the score and with an explanation of the major factors that are used in determining the score. And that is how you start the education process.

So the California law is something that we would like to see nationally. This is an absolutely essential piece of information that consumers need to have, that then provokes them to ask questions about not just what the factors are, but how they are weighted: What is more important, a collection or a delinquency? And they start asking questions about the underlying data. Is there a problem? Has one a creditor made a mistake in listing a delinquency that is not a delinquency? How do I correct it? This is all information the consumer should have.

Mr. MOSKOWITZ. And I would add one last comment to that, which is that, no credit score and no FICO score has ever been, in our company, the reason for a loan being rejected. It is a reason for a loan to be approved. If those issues or factors arise in the context of evaluating a consumer, we delve more deeply, analyze the reasons, look at the other factors in the broader underwriting spectrum that need to be examined.

Ms. HOOLEY. So I would assume——

Chairman BACHUS. We are actually over——

Ms. HOOLEY. Okay.

Chairman BACHUS. Had a little over 10 minutes.

Ms. HOOLEY. Sorry.

Chairman BACHUS. But I mean you have been a leader on this issue, so I want to give you some leeway.

Ms. HOOLEY. Well, maybe some of these questions I can write them up and have them answer them afterwards. I am really looking for, how do we do this in a way that makes sense for the consumer? How do we make sense, so that again, we can try to prevent identity theft, and again get through the process and make sure that we have accurate reports so that people are not turned down for inaccurate reports? And how do we educate the public on the issue?

Thank you, Mr. Chair, for your tolerance.

Chairman BACHUS. Thank you. Thank you, Ms. Hooley.

One thing that I would say that we talked about sometime, the vagueness of the response, like delinquency or serious delinquency. I think that part of that is civility. We don't want to say, you don't pay your bills or you don't pay on time or the other thing is liability. You know, if you get specific in a report, say that someone doesn't do this or that; I am just wondering if that may not be some of the reasons.

Mr. Meeks?

Mr. MEEKS. Thank you, Mr. Chairman.

Let me ask, Mr. Gambill, first question is how much money does it cost anyway? How much money did it cost to send out a report?

Mr. GAMBILL. We send out 8 million reports a year to consumers, and I said earlier, we have 4 million of them that ask us to re-verify issues or questions that they may have on those reports. We spend $60 million on that process.

Mr. MEEKS. And have you ever explored on, would it save money if you sent out some notification et cetera, electronically?

Mr. GAMBILL. We send out as many as we can, electronically, Congressman. The issue becomes the rigor with which we need to authenticate somewhat electronically, but be sure that they are who they say they are. We don't want people to get credit reports that aren't theirs. So we have to be fairly rigorous in the questions that we will ask before we deliver the report electronically.

We are now up to a point, where about 70 percent of the people that try to get their report electronically are successful at it. That will ultimately, I think, drive our price and cost down. But currently, that is——

Mr. MEEKS. As you move along and you begin to perfect it, that should help some cost down because, like my colleague from Oregon, I am concerned about identity theft, and I agree with also, Congressman Ackerman, who talked about when a person receives a negative credit information, it was hitting them, if the individual knows that a report is going to hit them immediately, number one, they can correct it, so that we don't have the of debt that was indicated by Ms. Hooley, where someone goes in for mortgage closing, or they go in for a job and they have a negative credit report, and then all of the sudden, they are hit with something they had no idea was there. And it takes time.

But if they had a notification at the time it had hit the report that they had a negative report, then that would help them and prevent identity theft, saving billions of dollars, I'm sure, because I know from the credit card company, that is one of the major problems that they talk about, they are loosing all kinds of money. Is there anything that you can conceive or come up with that would make it logistically possible to have something where there is a hit and a consumer knows about it?

Mr. GAMBILL. Those kinds of things are certainly possible if they are electronic. And we offer those kind of services to consumers on a subscription basis that can go through the rigor of being authenticated electronically so that we can, via e-mail, give them some electronic notices as to when things change about their credit files.

To wholesale mail, that kind of information out, I believe, would increase our exposure to fraud as a country, not decrease it, because I am sending information to some address about some individual, about some trade line, that hit some credit file, I have no real idea whether I have sent that to the right individual or not.

Mr. MEEKS. I just want to check, because someone told me that at a speech somewhere is it correct, that you said .6 percent of your revenue would gain from selling the report to the public. Is that correct?

Mr. GAMBILL. Well, your math is better than mine; it is about $30 million. I mean I will calculate that percentage if you would like.

Mr. MEEKS. Okay. Let me ask a quick question of Mr. Moskowitz.

I asked that because Wells Fargo gets my money every month. [Laughter.]

Mr. MEEKS. Might as well make you——

Mr. MOSKOWITZ. Mine too.

Mr. MEEKS. There is this huge concern about the crafting of privacy notices and legislation on privacy by various States. We have heard the testimony here. What would be your recommendations for a uniform national privacy law that would simplify the issues for customers without completely opening—and now is the big question—Gramm-Leach-Bliley? Is there any recommendation, you think? It took us such a long time to get there, you don't want to open the whole thing up. But do you have any recommendations?

Mr. MOSKOWITZ. Well, we agree that the possibility of inconsistent State privacy disclosures will confuse people, and we believe that regulators should be asked by Congress to improve existing annual notices and establish uniform disclosure requirements that make it clear how information is used by a company.

We are strong supporters, though, as you know, of the ability of a company, like a bank, with its operating subs, to organize itself in the way that it wishes to and to be able to freely share information internally to accommodate the needs of customers without restriction, except that as provided by existing FCRA law.

Mr. PLUNKETT. Congressman, I might just add—Congressman, this is Travis Plunkett.

I might just add that, the privacy notices are already regulated nationally through the Gramm-Leach-Bliley Act. So we are not going to see that change. We think the notices need to be improved, but that is a national regulation right now.

The folks who want to extend the affiliate sharing preemption, one of the eight preemptions under the Fair Credit Reporting Act, your question was how do we do this without messing with

Gramm-Leach-Bliley. And unfortunately, the proponents of extension of the affiliate sharing preemption have brought Gramm-Leach-Bliley into play already because they have claimed that the prohibition on States passing affiliate sharing restrictions for credit reporting purposes extends beyond that and actually affects the Gramm-Leach-Bliley Act and doesn't allow the explicit provision in Gramm-Leach-Bliley that allows States to go further with privacy loss. It doesn't allow those States to deal with affiliate sharing.

So we already have a linkage that folks who want to extend this affiliate sharing preemption have made the Gramm-Leach-Bliley, so it is hard to deal with the affiliate-sharing problem, and we think it is a problem, without bringing Gramm-Leach-Bliley into play.

Mr. MOSKOWITZ. And we don't think there is an affiliate-sharing problem at all. We believe that the ability to share information for appropriate purposes within a company that has chosen to organize itself in separately organized corporations, which could be organized that way for both expertise reasons, for regulatory purposes and liability purposes, is a primary driver of the efficiency of the market that has lowered interest rates for consumers.

It has allowed companies like Wells Fargo to develop innovative products that have allowed us to become the primary lender, the number one lender to low-to moderate-income groups and in low-to moderate-income communities, and to ethnic minorities. And those efficiencies are undermined by our inability to share information internally in a way that addresses those communities' needs.

Mr. PLUNKETT. And we have said we would simply like consumers to have the option to stop sharing of that information. And if they see an economic advantage, they will certainly allow it.

Mr. MOSKOWITZ. And consumers have the ability to opt out——

Mr. PLUNKETT. Not on affiliate sharing.

Mr. MOSKOWITZ. Yes, they do.

Mr. MEEKS. This is my last question, gentlemen, on affiliate sharing. Should the same be true of major corporations that provide completely different services, for example, commercial banking and investing banking?

Mr. MOSKOWITZ. The ability of a company that has unrelated business?

Mr. MEEKS. Yes.

Mr. MOSKOWITZ. Well, we believe that the most efficient way for a company with multiple businesses is to organize itself as the way it chooses to do so and to provide services to consumers in a way that is consistent with that organization, and not be forced to reorganize in a way that could accommodate that sharing and that is inconsistent with its own internal business model.

Mr. PLUNKETT. See, I don't think many consumers know about the affiliates of their bank, for instance. Many banks now have lots of affiliates. So the bank is also has an affiliate in the insurance business or the security business, I think, polls show again and again, consumers want the choice. They will consider the cost and the benefits, but they want choice to stop the sharing of that information between the bank affiliate, the insurance affiliate and the security affiliate.

Mr. MOSKOWITZ. And that choice could impact the ability of a company to control fraud, to manage its servicing portfolio and could be able to deliver its products to Wall Street in a way that reduces inefficiencies and increases cost.

Mr. MEEKS. Thank you. I yield back.

Chairman BACHUS. Thank you. I think that concludes our testimony of the first panel. I appreciate your testimony and commend you on your answers, and it has been very valuable to us as we consider this important matter.

First panel is discharged, and we will go right to our second panel at this time.

We want to welcome our second panel, from my left to right.

First panelist, Mike Vadala, president and CEO of Summit Federal Credit Union, located in Rochester, New York. Summit has $275 million in assets, 42,000 members from over 500 companies. Probably more importantly, he is the secretary of NAFCU. More importantly, I see you are active on the alumni board and the management advisory council of Syracuse University. I commend you on your NCAA basketball win, except for your victory over Auburn, which you got very lucky there.

[Laughter.]

Chairman BACHUS. But other than that, you probably deserved to win every game. And very active in various charities in the Rochester area. I welcome you back before the committee. I think you have testified, actually, in 1997 on credit cards and other different issues.

Our next panelist is Rusty Cloutier. He serves as a director of the New Orleans branch of the Federal Reserve Bank in Atlanta. President, CEO of MidSouth Bank, Lafayette, Louisiana, a bank of $365 million asset bank. Earned a Bachelor's in Science from Nichols State. Is that where Billy Tauzin went?

All right, so we know that is a very good institution.

He also served as a member of Fannie Mae's National Advisory Committee. Again, director of Our Lady of Lords Regional Medical Center, Chamber of Commerce and chairman of the Community Bank, Bankers of Louisiana. I welcome you to this hearing.

George Loban, co-chairman of FSF Financial Corporation and First Federal FSB, $560 million stock institution in Hutchinson, Minnesota.

Where is Hutchinson, Minnesota?

Mr. LOBAN. Hutchinson is just west of the Twin Cities, about 40 miles——

Chairman BACHUS. I see.

Mr. CLOUTIER.——40 or 50 miles, Minneapolis, St. Paul.

Chairman BACHUS. Then, a member of the board of directors of America Community Banks since 1998, serves on various committees for them. A chairman of the board of the Minnesota League of Savings and Community Banks, and served two terms as chairman and two terms as the member of the board of the Federal Home Loan Bank in Des Moines. So, welcome you and quite an experienced background.

Robert Manning is a Caroline Gannett Professor of Humanities, Rochester Institution of Technology, Rochester, New York. That is the same town that our first panelist is from, so we have two from

Rochester. Professor Manning recently wrote Credit Card Nation, which has gotten a lot of publicity. He has testified extensively before the Senate and the House on lending issues, credit issues, and sub-prime and predatory lending issues.

We welcome you back. I think this committee's well aware of your experience.

Dr. Manning is a past Fulbright lecturer to Mexico, Ph.D. from John Hopkins, Northern Illinois University, M.A. and B.A. from Duke University.

Our next panelist is Evan Hendricks, editor and publisher of Privacy Times, a Washington-based newsletter specializing in privacy acts and what else?

Mr. HENDRICKS. Fair Credit Reporting Act, medical records, employment records.

Chairman BACHUS. Privacy issues and various policy issues. He served as consultant on privacy and business issues for major corporations, including Ericsson, a Swedish-based wireless company. And since August 1998, served on the Social Security Administration's panel of experts. He was a paid consultant for CNN, Multi-State Tax Commission and various other commissions. He is quoted regularly in major and small newspapers including The Washington Post and The New York Times and ABC Nightline and is a familiar face on the nightly news. So we welcome you.

At this time, to introduce the general counsel for global consumer group for Citigroup, I am going to yield to the gentlelady from New York.

Mrs. MALONEY. I thank you for giving me the honor of welcoming one of my constituents from the great State of New York and the great city of New York. And I would like to introduce Mr. Martin Wong, and he is from Citigroup, one of our important financial institutions and he is general counsel of Citigroup's Global Consumer Group, and he has worked in various positions at City since 1987. He earned his B.A. in public administration from Loyola and J.D. from the University of Baltimore.

And we welcome him and thank him for taking the time to be with us. Thank you.

Chairman BACHUS. And our last panelist, Mr. Scott Hildebrand. He is vice-president, Direct Marketing Services for Capital One. He has had various responsibilities there, but direct marketing probably describes most of them. Prior to joining Capital One, Scott was vice-president at Epsilon, a leading database, marketing firm, formerly owned by American Express.

While there, he advanced customer relationship marketing, had a number of Fortune 500 companies improving customer retention, cross-sell and profitability. In addition, he served as a consultant for 80 little PepsiCo's Frito Lay and Kentucky Fried Chicken business units and the Marriott Corporation. He attended Georgetown University, B.A. degree.

And then he received his MBA, in marketing and finance, from the Kellogg School of Management at Northwestern University.

So all-in-all, a very competent panel. We look forward to your testimony.

And at this time, we will just go right to testimony.

Mr. SANDERS. I will be just very brief.

Chairman BACHUS. Well, actually, Mr. Sanders.

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

This is a very important panel dealing with a very, very important issue. The reality is that right now, in my view, among other problems with the industry, a major scam is being perpetrated on large numbers of Americans. And that scam, as I mentioned earlier, Mr. Chairman, and one of the underlying points that we have to reiterate, Mr. Chairman, is that not every American is all that sophisticated in all aspects of financial transactions. Bottom line is that companies promise people, or at least indicate that they are promising people, credit at a certain interest rate. And if I say to you, Mr. Bachus, I am going to charge you six percent for a year, your expectation is that if you pay your bills to me on time, that is going to be six percent.

That is usually the way we do business in America. And yet, increasingly, what we are finding is that those interest rates are zooming up despite the fact that the consumer is paying his or her bill to the credit card company on time.

But I can understand if I am late in paying the bill, you say, Hey Mr. Sanders, there is a penalty, they will raise your interest rates. If I pay the bill to you every month, on time, I have a right to believe that my interests are going to remain the same. And with the growth of sophisticated information acquisition, what credit card companies are learning, is that maybe 3 years ago, I was late in paying an auto loan. Or even more egregious, there was an illness in my home. I pay my bills on time. There was an illness and I have to borrow money to provide to pay the medical bills. And because I borrow more money, because I borrow more money, not because I am late in any of my payments, credit card companies say, well he is now a greater credit risk. He is more in debt. But maybe I pay my bills on time.

And arbitrarily and often, in fact, without the knowledge of the consumer, interest rates go way, way up: 25 percent, 30 percent, usurious rates, which are leading to bankruptcy and terrible situations for large numbers of the American people.

Mr. Chairman, I hope that we can work together on addressing this rip-off. Large multi-billion dollar companies should not be involved in a scam like that. They should be embarrassed. And I hope that we can discuss this today and vote in a bipartisan way, tripartisan way, in addressing this issue.

Mr. Chairman, thank you very much.

Chairman BACHUS. I thank the gentleman.

Mike, Mr. Vadala, you will lead off.

STATEMENT OF MICHAEL VADALA, PRESIDENT AND CEO, THE SUMMIT FEDERAL CREDIT UNION, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

Mr. VADALA. Thank you, Mr. Chairman.

Ranking member, Sanders, members of the committee.

I think I am glad we lost to Auburn in football this year, and I wanted to remind you of that so that we——

Chairman BACHUS. I had forgot about that.

Mr. VADALA. My name is Mike Vadala, and I am here today on behalf of the National Association of Federal Credit Unions to express our views on the Fair Credit Reporting Act. I am president and CEO of the Summit Federal Credit Union, headquartered in Rochester, New York. The Summit currently serves over 42,000 members in all 50 States. Due to the complexity of the different laws that exist on a State by State basis, the Summit does not offer real eState loans outside the State of New York, but we do offer credit for all other consumer purposes to our members. If the FCRA preemptions are not extended, it is likely that the Summit will not make any loans outside of New York.

The foundation of America's National Consumer Credit system is FCRA, enacted by Congress in 1970 to streamline credit reporting and to provide consumers with protection from inaccurate and inappropriate disclosure of the personal information by consumer reporting agencies. In 1996, the FCRA was amended and now contains seven specific Federal preemptions to ensure that the National Consumer Credit System remains viable and can continue to deliver affordable and accessible credit and financial services to consumers.

NAFCU agrees with Federal Reserve Board Chairman Alan Greenspan that Congress should permanently reauthorize the preemption provisions of the FCRA. Doing this, will give credit unions the ability to continue to offer their members credit in a timely manner and at a fair market price. It would also codify the ability of credit unions to share certain member information with our affiliates, thus making credit union members aware of the opportunity to obtain additional financial services.

Failure to reauthorize these preemptions could drastically change the way a credit union conducts business. A credit union such as ours could be forced to incur additional costs necessary to comply with several new and changing State laws.

As you may know, credit unions, on average, are small financial institutions and may not have the resources necessary to comply with differing laws across the States. They would, therefore, be forced to forgo lending in many States in which they have members. This could result in the potential of millions of consumers loosing a viable lending option and may make smaller credit unions even less competitive.

Credit scoring and credit reports are two important factors in evaluating the creditworthiness of borrowers. Combined with our loan office experience in judgment, credit scores and credit reports have contributed to a very successful lending program at the Summit. We acknowledge that at times there are errors in credit reports, but we are pleased with the improvement that we have seen in recent years as a result of National Standards and improved technology.

We have also found that many times, well-trained credit officers can find these errors. Errors aside, credit reports are very valuable in verifying that a member has listed all of his or her debts on a loan application. These reports also provide details as to the payment history on those debts. With more members opening credit lines in multiple States, it would be unquestionable or unreasonable for the requirements reporting to vary from State to State.

A consistent method of credit reporting allows us to get the information that is necessary to extend credit responsibly to our members.

Credit scores are also an important part in the extension of credit. At the Summit, we have found that the credit scoring modules are statistically valid, and that the accuracy of credit reporting and credit scores are much improved over what they were prior to 1996. We use credit scores to offer automatic approval on loans and to determine loan rates on several loan products. We find those with lowest credit scores have the highest delinquency rates.

There are many factors that contribute to credit scores including, repayment history, amount of credit owed, credit history, new debt and credit mix.

In general, people know that when they don't manage their debts properly, it will show up on their credit report and hurt their credit rating. But even so, more needs to be done to educate consumers about credit. As an institution owned by our members, the Summit's vision is to educate our members so that they understand their credit scores. Today, we are doing so on a case-by-case basis, if members ask for explanations.

Mr. Chairman, in conclusion, growth in the credit union community is strong and the safely and soundness of credit union is second to none. We are providing credit to more Americans in more locations than ever before. We urge the subcommittee to reauthorize the preemptions included in the FCRA so that we can continue our unique role in serving America's consumers, while strengthening our economy.

NAFCU thanks the subcommittee for the opportunity to appear before you today and comments the House Financial Services Committee for examining this important issue. Thank you.

[The prepared statement of Michael Vadala can be found on page 197 in the appendix.]

Chairman BACHUS. Thank you, Mr. Vadala.

And at this time we will hear from Mr. Cloutier.

STATEMENT OF C.R. CLOUTIER, CHAIRMAN, INDEPENDENT COMMUNITY BANKERS OF AMERICA

Mr. CLOUTIER. Mr. Chairman, I had the honor, a week ago, to be with the Community Bankers of Alabama, and they talked a lot more about football between Auburn and Alabama than we did about banking, but it is my pleasure to be here today and I appreciate the invitation from you and ranking member, Sanders and the members of the committee.

My name is Rusty Cloutier. I am chairman of the Independent Community Bankers of America and president of MidSouth Bank National Association, a $400 million community bank located in Lafayette, Louisiana. I am glad to be here today on behalf of the Independent Community Bankers of America, representing over 46,000 small community banks across America that want their voice heard.

ICBA supports the FCRA uniform national standard that will expire on January 1, 2004, and we strongly urge the committee to make these provisions permanent. Within the text of FCRA, Federal preemption is essential to ensuring constant uniform standards. FCRA is an important tool in promoting economic growth and uniform credit reporting standard also insure the availability of credit, especially to the low and moderate-income borrowers that are so important in my State of Louisiana.

If Congress fails to renew the uniform standards, the current system will be undercut by the enactment of a myriad of State laws with potential conflict standards. This will result in increasing costs to the industry and a significant impact on a bank's ability to evaluate the creditworthiness of its customers.

We live in a highly mobile society. Customers often move frequently and live in several different cities and States. Some community banks serve customers in neighborhood States and allow customers to apply for credit over the Internet.

Certainly, a bank does not have to consider a customer's State or States of residence when reviewing his or her credit report in order to understand what, where and when and how the information was reported. The information reported in my credit report is based on the same Federal standard as the information in yours. Without uniform national standards, how and when information, such as loan delinquency, payment history is reported, would detrimental, would be determined by each State.

A borrower from Louisiana would then have a credit report with different standards and containing different information from that of a borrower from the State of Alabama or the State of Mississippi. And if that borrower had lived in each of the States, his credit report would contain the information reported, based on the standards of each of these States. This would be overwhelming for both the bank and the consumer to understand. Community Banks want clear and consistent policies and standards.

The history in the success of community banking in this country is predicated on the extension of credit. Our current system is fair and effective. Consumers have grown accustomed to the availability of quick low-cost credit. Stricter consumer protections on a State-by-State basis will ultimately be detrimental to the consumer who may experience delays in credit decisions and banks may lose the opportunity to extend credit. Reauthorization of FCRA uniform provisions will benefit both consumers and community banks.

Let me turn for a moment to a very important issue of identity theft. It is the nation's fastest growing crime and resulted in at least $1 billion dollars in losses to banks last year, including mine. FCRA plays a major role in this fight. Therefore, it is essential that the current national system of credit reporting is maintained. ICBA strongly supports measures to thwart identity theft.

We would also support measures to allow customers to obtain a copy of their credit report free of charge annually. The benefit to community banking and having a customer who has been able review his credit report outweighs the cost of lost opportunities to extend credit to that customer due to inadequate or incorrect credit file information that may take several months to correct. Our customers should not have to be faced with denial of credit before they are able to receive a free credit report.

Information sharing is also an important topic in this debate. ICBA strongly urges the committee to maintain an appropriate balance between the critical protection of a consumer, financing privacy and the community banks' legitimate information sharing needs, that insures our customers have the essential products and services they need. The use of outsourcing in joint agreement with trusted long-term partners is vital to our ability to compete.

The joint agreement business model that we use is the same as the affiliate model for large banks and should be treated the same. Treating these business models differently would be unfairly discriminated against community banks in small communities that they serve, because of their regular size and corporate structure.

Please remember that it was not the community banks who started the discussion on privacy by selling their information.

A consumer opt-in requirement would be detrimental to the community banks and to their customers. Thus far, only 5 percent have opted out of having the information shared with affiliate third-party, so it is likely that opt-in rates would be similarly as low.

In conclusion, FCRA and the nation's credit reporting system, helps ensure that customers can easily access complete competitively priced products. The reliability of credit information, in maintaining, by the credit bureaus is critical to this goal.

ICBA strongly urges the committee to support the permanent reauthorization of the uniform national standards that will sunset on January 1, 2004.

Thank you for the opportunity to testify today and I will be glad to answer any questions at the appropriate time.

[The prepared statement of C.R. Cloutier can be found on page 73 in the appendix.]

Chairman BACHUS. I appreciate that, Mr. Cloutier.

And Mr. Loban, if you will testify?

STATEMENT OF GEORGE LOBAN, CO-CHAIRMAN AND PRESIDENT, FSF FINANCIAL CORPORATION AND FIRST FEDERAL FSB, HUTCHINSON, MN, ON BEHALF OF AMERICA'S COMMUNITY BANKERS

Mr. LOBAN. Thank you, Chairman Bachus, Ranking Member Sanders and members of the committee.

My name is George Loban. I am the co-chairman and president of FSF Financial Corporation and First Federal Bank. We are a $560-million stock institution based in Hutchinson, Minnesota. I am testifying today on behalf of America's Community Bankers, where I serve on the board of directors and as chairman of the Privacy Issues Subcommittee.

I appreciate this opportunity to testify on the role of the Fair Credit Reporting Act and the credit granting process. The FCRA aids uniform national standards allow community banks and others to make prudent credit decisions quickly and inexpensively wherever a customer may reside. They insure that credit reporting information is consistent from State to State, facilitating a national market for credit and risk management. This, however, is scheduled to change if Congress does not, by the end of this year, reauthorize the FCRA's uniform national standards.

Failing to act could result in a patchwork of conflicting State laws and substantially erode the quality and integrity of our credit reporting system.

More importantly, a lapse in reauthorization could drastically impact a wide variety of players in our economy.

For example, my institution serves consumer mortgage customers in over 40 States. Yet, we are by no means, a large business. If we were forced to comply with 40 different State laws, we would be forced to either to hire a team of compliance specialists, or else we would have to turn away out of State customers. The FCRA's uniform national standards allow First Federal to service mortgage customers effectively nationwide, and at a lower cost.

Our story is just one real life example of why Congress must reauthorize this year's FCRA's uniform standards on a permanent basis.

We also urge that laws regulating information sharing practices not discriminate against financial institutions based on size or corporate structure. Community banks often work with third parties affiliated and nonaffiliated to offer our customers new financial products. Where no affiliation exists, there is a contract dictating how and what information may be shared.

The disclosure and opt-out requirements of the Gramm-Leach-Bliley Act treat certain disclosures of information between financial institutions and a third-party identically. Regardless of whether the two institutions are affiliated, ACB urges that any prospective laws follow suit.

Our system of credit, however, is not without it glitches. The rising number of identity theft cases is creating enormous hardships on victims and community banks. This disturbing trend indicates that something more needs to be done to safeguard information from perspective identity thieves.

ACB urges Congress to pass legislation to increase sentences for identity thief crimes and make it easier for prosecutors to prove identity theft. We also look forward to working with the subcommittee on additional legislation to help combat identity theft.

Finally, improvements should be made to the credit reporting system itself to help protect consumers. During debate on the regulatory release bill, representative Gary Ackerman sponsored an amendment requiring Federally insured depository institutions to notify a customer every time it furnishes negative information to a consumer reporting agency.

This amendment would result in billions of new notices sent to consumers monthly. This would greatly increase cost and paperwork burden of financial institutions and their customers.

ACB and others opposed a similar amendment last year. But while we disagree with Representative Ackerman's proposed solution, we recognize that he may have identified a problem.

The continued integrity of the Federal Credit Reporting System demands that credit reports be as accurate as possible. ACB supports empowering consumers by providing them access to a free annual credit report, and enhancing their ability to correct errors on their credit reports, especially those resulting from incidence of identity theft. While we recognize that these tools do not come without some cost to the industry, we believe these costs can be balance against the benefits provided to consumers.

Again, thank you for this opportunity to testify. I look forward to any questions you may have.

[The prepared statement of George B. Loban can be found on page 132 in the appendix.]

Chairman BACHUS. I appreciate that, Mr. Loban.

Our next panelist, Dr. Robert Manning—Dr. Manning?

STATEMENT OF ROBERT MANNING, PROFESSOR OF HUMANITIES, ROCHESTER INSTITUTE OF TECHNOLOGY

Mr. MANNING. Thank you, Chairman Bachus for providing the opportunity to share my views with the committee on this increasingly important topic of credit card industry policies and the protection of consumer rights under the Fair Credit Reporting Act.

Also like to commend Ranking Member Bernie Sanders for his efforts in protecting consumers from deceptive marketing and contract disclosure practices of the credit card industry.

These twin issues of rising consumer debt and shockingly low levels of financial literacy, which includes, a lack of understanding of consumer rights which have grave implications that the continued well-being of the nation, especially as Americans cope with these increasingly perilous economic times.

Today, I would like to direct my focus on the impact of Federal deregulation on banking as it affects consumer lending, specifically, revolving credit. How the enormous profitability of the industry has created institutional pressures to increase its client base, consumer debt levels and especially escalating penalty fees. And then, conclude by examining specific abuses that are facilitated by the FCRA and its implications of statutory reform.

I think what is critical to our understanding is that we have gone from a system of community banks to one of national and global conglomerates where the demand for crossmarketing with affiliates through such merges as Travelers and Citibanks have lead to increasing strain on consumer privacy and the availability of consumer financial information.

In this period of the last 20 years, the best client has been transformed from installment lending contracts with people who had low debt levels, to today, the best client is someone who will never repay their loan, specifically through unsecured or revolving credit.

Credit cards have played a pivotal role in the transforming of the structure of the financial services conglomerates, and I show you in chart one, it gives a lot of the empirical background for my presentation, but the key is, since 1977, we have gone from 50 banks controlling about half of the market to today, 10 banks control 80 percent of the credit card market.

And this, I believe, is critical as we look at the rise of the nationally chartered banks that through their process of consolidation it has severely reduced the role that local and State level legislation plays, and that this lack of regulatory control over issues such as, State usury laws, fee caps, mandatory arbitration, meaningful notice of disclosure has really shifted the emphasis now about Federal preemption, and its role now moves increasing to Congress, especially to this committee.

We all know the enormous profitability of the credit card industry today, even during this recession, even though we have heard many complaints that the industry is suffering. In fact, and over the last 10 years, the credit card industry's profitability has more than doubled, and the banking industry as a whole. And recently, we can look at it terms of the sale of credit card debt, from 18.4 percent premium paid last year, actually risen to 19 percent today.

In terms of FCRA, I think what is critical here is that the institutional pressure to recruit new people, and particularly people with the least knowledge of their rights under FCRA, and especially in terms of the terms of their contracts, has lead to a dramatic increase of fee revenue, from $1.7 billion in 1996 to $7.3 billion in 2002.

Who are some of these people that we see now that with some of the amendments of the 1996 FCRA, that are being increasingly solicited? What we have seen is, a tremendous increase in the working-poor, households with less than $10,000; senior citizens and college students. And I refer to the charts that show the dramatic increase in working-poor households where average debt of a recent survey of the University of Michigan's Consumer Finance Survey shows that the biggest increase in credit card debt is among those households with less than $10,000, from less than $600 in 1989 to over $24,000 in 1998.

And in my comments, I included a case to show the abusive contracts that have been offered in this process, where a $400.00 credit limit includes $371.00 in fees. We looked at seniors who, for the first time, are now being aggressively solicited, 65-year-olds, we are seeing that their average credit card debt is more than doubled in this period of time.

And I refer to my most recent survey of college students, which shows now, the shifting of the marketing permitted now. With under the 1996 amendment, that we seen a dramatic shift, not from upper classmen, but to freshmen and even high school students, where the supposed ability of students to pay for their loans neglects the debt component where you will see from the data that more increasingly, three-fourths of college students with student loans are using them to their credit cards. Sixty percent of freshmen are actually using, have maxed out on their credit cards and using one credit card to pay for another.

So I want to conclude with three specific cases that I think are particularly germane to today's discussion. One is the issue of prescreening that enables banks to look at a client's accounts with other banks. When is a fixed loan really a fixed loan over the term of the contract? And I refer to cases where people specifically have had their interest rates raised from 0 percent to 25 percent because of outstanding debt balances on other accounts.

I would like to emphasize also, with my participation in some FCRA litigation, that there needs to be an extension of the period of time for filing litigation. Many consumers clearly do believe that banks and the credit reporting agencies will respond to their requests, and for those who fall through the cracks, we really need to accommodate their special circumstances.

And I want to conclude with a final case that I feel is particularly important to those both that link both issues of credit cards and housing. And that refers to the case of Household Finance versus ACORN, where the screening process was specifically to seek two criterion, people with high credit card debts and people who own homes. And the point of this marketing program was to upsell, that is to consolidate credit card debt into the home mortgages, and through this process of consolidation, these higher interest rates meant that there could not be a possible home refinance nor could the home be sold, because it had negative equity.

So for these and other reasons, I hope that the committee will carefully examine the impact of FCRA reauthorization, not only for process of fairly granting, but also fairly administering consumer credit accounts.

Thank you.

[The prepared statement of Robert Manning can be found on page 138 in the appendix.]

Chairman BACHUS. Thank you, Dr. Manning.

At this time, I have to go out and make a statement. So I am going to switch chairs with the gentleman from Ohio, Mr. Tiberi who will chair the hearing.

And Mr. Hendricks, we will start with your testimony.

STATEMENT OF EVAN HENDRICKS, EDITOR, PRIVACY TIMES

Mr. HENDRICKS. Thank you, Mr. Chairman and Congressman Tiberi.

My name is Evan Hendricks, editor and publisher of Privacy Times.

I come today prepared to discuss solutions to some of the problems.

And yes, we have what may be the best credit reporting system in the world, but the great thing about this country is we never stop trying to improve it. I think, more importantly, there is substantial evidence of potentially deep flaws in the system that are harming consumers, and also new evidence that marketing of credit services might be facilitating identity theft. I intend to explore those.

With the advent of the national credit reporting system, we realized we needed a Fair Credit Reporting Act. We enacted one in 1970.

In 1990, problems with inaccuracies in credit reports was the leading cause of complaints to the Federal Trade Commission, so it took 6 years to upgrade the law. It should be no surprise right now that we need to continue to advance consumer protection in this area, and we need a strong national floor, and that the States play a very important role in consumer protection.

The main purpose of the 1996 amendments was to make the correction of mistakes in the credit report, a routine process and to articulate a higher standard of care, to make it so you don't have file a lawsuit to get your credit report corrected.

Unfortunately, that goal has not yet been achieved, as I have seen in too many instances how, that the only way a consumer could get a credit report corrected was by going to court. That is clearly not the policy we want running this country, and when we are trying to cut down on litigation. Yet the practices of some furnishers and some credit reporting agencies actually encourage litigation for those that really care about protecting their good name.

Another reason behind the 1996 amendments was inaccuracy. Clearly the CFA study, along with the Federal Reserve Board study, documents serious problems with inaccuracy. And I think

Chairman Greenspan and his staff should read their own report, before they address this issue again.

The dispute numbers at the CRAs, Credit Reporting Agencies are running, typically, 7,000 to 10,000 disputes per day, and this allows, with the number of staff they have and the number of disputed items per report, sometimes they really only have two minutes or so to deal with every dispute.

Credit grantors, like Capital One, are seeing their disputes go up from 1,000 a day about 18 months ago, to now, 4,000 disputes a day. They deal with this by having an automated dispute problem.

One of the things that can cause inaccuracies in credit reports is the use of partial matches, and I have seen this over and over again, where a credit bureau will say, if your Social Security number's not the same, if there is one digit difference, sometimes they will assume that if there is enough common letters in the first name, then they will assume it is the same person, and they will merge that information together. And so, it is this use of partial matches of both partial name matches and partial Social Security numbers, which causes great deal of inaccuracy. And I have detailed this in my statement.

They deal with the high volume of disputes by using an automated system to have basically this exchange of messages between the credit grantor and the credit bureau, in which the credit bureau asks, after a dispute, Did you say this? And the credit grantor comes back and says, Yes, that is what we reported. But they don't really try and investigate in a true sense of the word to get to find out what the truth is.

In my statement, we have talked about a lot of the damages that come to consumers in this area. I have also urged this committee to try and hold hearings, at least spend a morning or so, listening to the victims of mixed files and identity theft, so you can get a full range of the damages that people have to undergo when they are pitted with problems in the system. Not only can inaccurate data lead to credit denials, but it also can lead to price-hikes in the age of risk-based pricing, and cause the emotional distress of trying to correct a credit report mistake that was not of your making. The damages are extensive.

In three of the seven areas, where there is preemption, one of the areas is prescreening. I have just begun an investigation into this area, and with two phone calls, I have found that there are major criminal gangs across the country that are hitting mailboxes, trying to get any personal information they can get, including pre-approved credit card offers, also convenience checks, bank statements, so that they can take this personal information and use it to facilitate identity theft.

There is quite a range of sophistication among these groups. Some try and use the pre-approved credit cards or convenience checks to get money instantly. Others take the personal information and sell it to fences that are more sophisticated in counterfeiting and identity theft.

I think in this area I think that we need a stronger national standard, because if you look at your prescreened offers, you will see that even though the law says the notices are supposed to be clear and conspicuous, they are neither clear nor conspicuous, and that we need to go beyond that and to have basically a national opt-out registry for credit offers through the mail, just as we have a registry to stop junk phone calls.

The duty on furnishers, is also a preempted area. But this is a very weak standard that basically sets up too many hoops the consumers must jump through in order to facilitate simple correction of their errors. I detailed in my statement some of those hoops they have to jump through and why a stronger standard is necessary. If Congress is unable to enact the stronger standard, then we need to let the States feel free to move forward and protect consumers in this area.

The final area is affiliate sharing, and despite all the talk of the need for a national standard, the FCRA sets no standard for affiliate sharing. It just says that the States will not enact anything in this area. So basically, it favors a national standard in an area where there is no national standard.

Now, Gramm-Leach-Bliley has some national standards to the sharing of financial data, which is simply a very weak and watered-down opt-out for sharing with third parties. Yet it too does not set a standard for affiliate sharing.

And so, the FCRA provisions are being invoked by Wells Fargo and Bank of America in litigation against localities and ordinances to try and stop those places from protecting their citizens with stronger privacy protection.

In closing, I would like to say that this is an extreme importance to the American consumers. The top complaint back in the 1990s was about credit reports; now it is about identity theft. It leads the complaint list about all sorts of other issues that involve out-of-pocket losses.

I think it is very important to the people of America to protect their good name. I think that is a major item that this law is all about and that is why there is a grave responsibility to this Congress to enhance consumer protection.

Thank you.

[The prepared statement of Evan Hendricks can be found on page 109 in the appendix.]

Mr. TIBERI. [Presiding.] Thank you, Mr. Hendricks.

Mr. Wong?

STATEMENT OF MARTIN WONG, GENERAL COUNSEL, GLOBAL CONSUMER GROUP, CITIGROUP, INC.

Mr. WONG. Good afternoon, Chairman Bachus, Congressman Tiberi, Ranking Member Sanders and members of the subcommittee. Citigroup thanks Chairman Bachus and Chairman Oxley for their leadership and holding these hearings.

Today, I want to emphasize the importance that Citigroup attributes to reauthorizing the national standards contained in the Fair Credit Reporting Act. FCRA provides a national framework for the credit reporting system, which has been shown to work well and to provide substantial economic benefits to consumers. These benefits include affordable credit, wide credit availability and protection against fraud and ID theft.

FCRA appropriately balances a wide range of consumer protections, with the crucial need for creditors to have access to a uniform national database on which to make credit decisions. It is essential, therefore, that Congress act to preserve the national framework that is scheduled to expire at the end of this year. While maintaining national standards for all seven of the key provisions is crucial, I want to highlight a few areas that are especially important to Citigroup and explain why they affect our ability to continue to serve our customers well.

First, affiliate sharing. Citigroup shares information among our affiliates for many important reasons, such as control and credit risk, credit monitoring and fraud control. It also is important in identifying products and opportunities that may be beneficial to customers. Sharing information among affiliates greatly assists in the prevention and detection of ID theft. It helps to detect unusual spending patterns and habits that are used to identify fraud and allows us to promptly notify the customer.

The ability to share information among affiliates also conforms to customer expectations. For example, a Citibank customer expects to be recognized and demands a certain level of service and accountability whenever visiting a Washington, D.C., Citibank branch of our Federal thrift, or a New York Citibank branch of our national bank. The legal distinction between the two affiliated Citibanks is not relevant to the customer, and it should not affect his or her ability to obtain products and services.

In 1996, Congress struck the appropriate balance between the consumer protection and business needs by allowing customers to opt-out of having certain information shared among affiliate entities. If different States were allowed to pass laws governing the exchange of information among affiliates, it would significantly disrupt out seamless nationwide system of serving our customers. Complying with a patchwork of State and local laws would be extremely burdensome and costly for lenders, and ultimately for consumers.

Second, and I want to talk about prescreening. Prescreening is essential for targeted marketing. Credit card issuers and other lenders use prescreening to substantially reduce the cost and increase the efficiency of identifying potential customers.

For consumers, targeted marketing is vastly preferable to the most likely alternative, blanket marketing. Most new entrants and major competitive initiatives in the credit card industry in the last 20 years were based on prescreening. These competitive initiatives have provided consumers with lower interest rates, cards without annual fees and an array of new discount and bonus features. Prescreening allows institutions to control their risk by targeting those individuals that meet certain credit standards.

Accounts obtained through prescreening have lower loss rates and less fraud than other forms of account acquisition. The prescreening provisions appropriately balance the need for consumer protection by providing consumers with the ability to opt out for a single toll-free call. If States were allowed to adopt different rules for prescreening or prohibit prescreening, consumers would not be able to enjoy the same benefits derived from robust national competition that they receive today.

Finally, I want to talk about the provisions dealing with the content of credit reports. Uniform national guidelines for credit report information allow creditors to price risk more accurately, which results in lower cost for all consumers and more credit availability.

If the FCRA provisions that dictate the content of credit reports were allowed to sunset, an individual State could pass a law prohibiting creditors from reporting to credit bureaus until borrow payments were at least 90 or even 180 days past due.

For credit grantors, the result could be disastrous. It would grant credit to consumers who appear to have unblemished credit, but in fact, would have a very high risk of default. The universal response of lenders to increase credit losses is to raise interest rates and to reduce credit availability. This is not a desirable result for our credit society.

Thank you again, for the opportunity to appear before the subcommittee.

[The prepared statement of Martin Wong can be found on page 207 in the appendix.]

Mr. TIBERI. Thank you for finishing before your time even expired.

Mr. Hildebrand?

STATEMENT OF SCOTT HILDEBRAND, VICE-PRESIDENT, DIRECT MARKETING SERVICES, CAPITAL ONE

Mr. HILDEBRAND. Thank you, Chairman Bachus, Ranking Member Sanders, Congressman Tiberi and members of the subcommittee.

My name is Scott Hildebrand. I am appearing here today on behalf of Capital One Financial Corporation, where I serve as the vice president for Direct Marketing Services. On behalf of Capital One, let me express my thanks to you, Mr. Chairman, and Chairman Oxley for the leadership that you have shown on this important issue.

At Capital One, we believe that permanent extension of the national standards contained in the FCRA is essential to the continued health of our nation's economy. Capital One's one of the top 10 largest credit card issuers in the nation and a diversified financial services company with over 48 million customer accounts and $68 billion in managed loans, outstanding.

In many ways, Capital One is a creation of the competitive environment established by the uniformity provisions of the FCRA itself. This competitive environment commenced 30 years ago with the passage of the FCRA and accelerated greatly with the amendments to the Act in 1996. We would not have seen today's level of competition in the balkanized, localized credit card markets of 30 years ago. Even as late as 1987, the credit card market was mired in a one-size-fits-all approach, characterized by across the board rates of 19.8 percent and annual fees of $20.00.

That market was ripe for innovation, and companies like Capital One saw an opportunity to utilize the information provided by the national credit reporting system to customize product offerings to customers based on particular needs, interests and risk profiles.

Our founders realized that a one-size-fits-all approach made little sense in an environment where each consumer possessed vastly different needs and characteristics. While some consumers are risky, many more were not.

Either way, consumers suffered. The less risky customers were simply paying too much and for the rest, credit was hard to come by, if available at all.

Capital One was able to utilize information within the legal framework provided by the FCRA to make significant advances in underwriting, better distinguishing the risk characteristics of our customer base. Capital One and other companies were also able to utilize information to create profound innovations in the marketing and product design of credit cards. Our company, for instance, lead the charge with new product ideas, like balance transfers.

By 2003, the moribund competition, the flat pricing structure of old, was no more. In its place, came fierce competition with fixed rates as low as 6.9 percent and no annual fees commonplace. According to Robert Turner, in his testimony last week, this price competition produced $30 billion in annual savings for consumers across the country.

Capital One has been able to take this market-leading approach in reinventing other lending businesses as well, including auto finance. We have pioneered innovations, such as a unique auto refinance product, that allow consumers to take advantage of lower rates like they do when mortgage rates decline.

With regard to specifics of FCRA, two major provisions warrant further explanation. Data credit consistency and permitted uses of credit data. The credit data consistency provisions strike a sensible balance that enables companies like Capital One to construct highly accurate credit models on a nationwide basis. Based on the voluntary nature of the system, it is a frustrating argument for those of us who use the data as part of credit granting process that, the argument being, that we do not have a significant stake in the accuracy of that information provided on consumers. Put most simply, at Capital One, our models do not work if the information contained in the bureau reports is not accurate.

The permissible use provisions enable companies like Capital One to use information to reach potential customers and to make prudent credit decisions. Prescreening reduces risk. Losses from customers obtained through prescreened offers of credit are significantly lower than losses of customers obtained through other nonprescreened channels. This provides a vital tool in ensuring the continued safety and soundness of consumer lending institutions.

Prescreening fosters competition by allowing financial services firms to identify the credit characteristics of individuals and offer them credit products with tailored terms and conditions specifically designed to beat the competition. Prescreening fosters innovation. Extraordinary ancillary benefits, such as airline miles and cash rebates attached to modern credit card products are largely a function of prescreening.

Prescreening is transforming other businesses as well. Our highly successful auto refinance product, which can save consumers up to 4 percent on their loans, is made possible through prescreening.

Prescreening reduces identity theft. Our data demonstrates that rates of fraud are 5 to 15 percent times lower for credit granted through prescreening than from credit generated through other channels.

Our credit system is the envy of the world. Consistent national credit data is the foundation of this system, ensuring that Americans have more access to credit at lower prices than our counterparts around the globe.

Our best credit card customers today enjoy a fixed rate as low as 6.9 percent, with no annual fee. The variety of programs and rewards available simply boggle the mind. These tremendous innovations have saved borrowers billions of dollars.

The FCRA is a vital instrument, preserving the vitality of our credit granting system and equally, a vital instrument in preserving the vitality of our modern economy.

We urge you to reauthorize these provisions and to extend permanently, our national uniform system of credit reporting.

Mr. Chairman, Mr. Congressman, members of the subcommittee, thank you very much for the opportunity to testify before you. I will be happy to answer any questions you have at this time.

[The prepared statement of Scott Hildebrand can be found on page 122 in the appendix.]

Mr. TIBERI. Thank you. I don't think I have seen two panelists in the same panel ever complete their testimony under time. I congratulate both of you.

Let me just begin asking a question relating to something you just said with respect to prescreening, that prescreening lowers the fraud rate. Can you explain why you believe that is or why Capital One believes it is?

Mr. HILDEBRAND. And it is a great question, Congressman. It is true, it is about five to 15 times lower fraud in prescreening, depending on the segment of the population. Primary reason being that this is a known individual. That is that we have a peek into their credit records through prescreening, we offer it out to them, the application comes back to us. In a non-pre-approved environment, we do not have all the checks and balances that prescreening affords us. So it is another data point on the consumer.

Also, there are fraud tools that are available that, when an application comes in, there are certain indications on an application that it may or may not be fraudulent. After looking at millions and millions of applications through prescreening, we have been able to model these, and so when applications come through that look a little bit out of the ordinary, our models squeeze those out and we flag those for fraud. We then proceed to make a verifying phone call to the true name person, to verify that, indeed, they did apply for credit.

Mr. TIBERI. I have heard a little bit more about the use of prescreening being critical of the underwriting and the use of prescreening as a risk management tool. What is your sense of that?

Mr. HILDEBRAND. Oh, it clearly is. Prescreening is indeed an underwriting tool. In effect, what we were doing is we are ensuring that the folks, the consumers that we are going to offer credit to, are credit worthy.

The last thing that we want in our industry is to have people get overburdened, get in trouble, because we have to foot the bill for that. So prescreening affords us the opportunity to pre-select those customers who we think are most creditworthy and offer them products tailored to their situation.

Mr. TIBERI. And those who would criticize prescreening, as Mr. Hendricks did, your response to that would be?

Mr. HILDEBRAND. Prescreening is much, much more than a marketing tool. It is indeed an underwriting tool.

Mr. TIBERI. And if we didn't have prescreening today, what would be the outcome to Capital One customers, in your judgment?

Mr. HILDEBRAND. Well to our existing customers, no impact. To prospects, I hearken back to Mr. Gambill's testimony earlier today. I believe there would be much, much more mail on America, because we are still going to try to acquire new customers. I believe that—I can't speak for Capital One, because we have not modeled this behavior—the general consensus in the industry is that there would be less credit available. That it would probably be more expensive, because marketing costs would go up dramatically, based on the fact we are trying to reach many more people, not understanding the credit risk behind those folks, as prescreening affords us.

Mr. TIBERI. Thank you.

Mr. Wong, you mentioned affiliate sharing from Citicorp's point of view. Can you give some specific examples how affiliate sharing proactively and positively impacts me as a customer?

Mr. WONG. Absolutely, Congressman. Congressman, if you walk down the street into one of our Citibank branches, you may be interested in a variety of financial products. He may be interested in a deposit account, such as a checking account. He may be interested in a credit card, mortgage or even, perhaps, an investment account to purchase a bond. Each of these products are being offered by different affiliates of Citigroup, and if we did not have information sharing, as you open each of these accounts or purchase one of these products, you would have to go to an elaborate opening account process because we couldn't share the information.

Mr. TIBERI. How would you categorize the ability of affiliate sharing to help crack down on identity theft within Citicorp?

Mr. WONG. Very simple example: You, in your pocket, may have two credit cards issued by Citigroup. You may have an American Airlines Citibank credit card, or you may have a Shell card for your gasoline purchases. Those are two different affiliates within Citigroup. If we were to detect a fraud on one of your accounts, unusual spending habits, for example, and it confirmed that it could be a fraud with you, we would then alert all the other affiliates within the Citigroup and could place a fraud alert.

Mr. TIBERI. If we restrict or eliminate the use of affiliate sharing, what impact would that be to a customer?

Mr. WONG. Tremendous. I think the customer, for one, would not have the ability, in the case of product innovation, to get the benefits that Mr. Hildebrand described in his statement. Annual fees, doing away with annual fees and credit cards mileage programs, all of those things are innovations as a result of affiliate sharing looking at what customers want from a broad spectrum of customers. The seamlessness of conducting business with a customer would go away. It would be painful for a customer to buy more than one product within the Citigroup family of companies.

Mr. TIBERI. Thank you. My time has expired. I will yield time to Mr. Davis.

Mr. DAVIS. [Presiding.] Thank you, Mr. Tiberi.

Let me welcome all of you this afternoon. There are three of us who were here that here listening to you. So I apologize for not having a larger crowd than that.

Let me follow up, Dr. Manning, on something that you talked about earlier, and that is the problem, or perhaps it is not a problem from everyone's perspective on the panel, but the issue of college students and then the secondary issue of very low income people being singled out for a lot of the prescreenings, for a lot of the solicitations.

And I will ask you all to educate me a little bit as a matter of economics on this issue. To a lot of us, I think that it is somewhat counterintuitive that two of the groups of people who are singled out are those who are probably least likely in some ways to be durable credit card customers, or if they somehow become durable credit card customers, they are among the most likely people to have default issues or to have difficulties paying their accounts off.

Dr. Manning, some of your data really caught my attention. You said that roughly 60 percent of students who get credit cards, the overwhelming majority of those, I assume get them after some kind of prescreening solicitations, max out during the freshman year. A significant number of those who don't max out are having to use allowance from Mom and Dad or some other source to provide payments, and that, in effect, the first significant debt that a lot of young people incur now is not their student loans, frankly, it is the credit card bills.

Any one of you, I suppose, but in particular Mr. Wong and Mr. Hildebrand, tell me why economically it becomes so beneficial for the credit card companies to solicit people who, on their face, appear to be very high-risk customers, particularly with respect to college students?

Mr. WONG. May I?

Mr. DAVIS. Yes.

Mr. WONG. We believe that the credit card is a important payment tool in society today. Credit cards are needed for a variety of things from getting a reservation in a hotel room to acquiring a ticket online, an airline ticket.

College students, we do lend to college students. Our experience of college students do not suggest at all that this is a population of borrowers that are a greater credit risk to themselves or to us.

Mr. DAVIS. What is their default rate?

Mr. WONG. The default rate of credit of college students, and I don't have precise numbers, but I will be happy to share that with you.

Mr. DAVIS. Do you know that, Mr. Manning? Do any of you know the default rate for college students?

Mr. MANNING. I would love to. That is information the industry doesn't share with me.

Mr. WONG. But we can tell you that the default rate of college students is no greater than the general population of credit card holders in our customer base. And we obviously tailor the product to college customers to make sure that they are within their affordability in lines of credit. So obviously, it gives them great consideration.

Mr. DAVIS. Dr. Manning, what is your perspective? Obviously, we have the industry's perspective, I assume. That they are tapping a relatively untapped market. What is your perspective on this? Obviously, you have identified it as something you view as something of a social problem that a class of people are being targeted who are assuming a fairly large debt burden as they move into society.

How big a problem is this, in empirical terms?

And number two, what is the practical solution? I mean, presumably no one advocates it. I don't see a vehicle to prevent these companies from prescreening college kids, but they certainly have rights. They are legal adults. But what, from a policy standpoint, would you have this institution do if it wanted to address this matter?

Mr. MANNING. Well, first, there are a couple of issues.

Number one, the very fact that you are a college student is the prescreen, and that the industry puts on its head the underwriting criteria. If you have an 18-year-old that makes $5,000 and is not in college, most likely he or she will get rejected for a credit card. But if you are in college, you are going to get access to multiple thousands of dollars of credit cards during your collegiate career. So point number one is we need consistency for the industry.

Number two, of course, the Citibank now is very active in the student loan market. And in terms of affiliate sharing, we have some very serious issues here, that one affiliate knows that the other affiliate can get paid through this borrowed money.

I want to make it clear I am a very strong supporter of credit cards. I would like to see every student get a credit card with a $500 credit limit, if their parent will not cosign for them. But that limit could not be raised at the end of the year unless there has been prudent use of that credit card.

So I am not trying to discourage use of credit cards. I am trying to promote its effective use.

But I think the data here is unambiguous about the seriousness of the problem. We are no longer talking about marketing seniors who have some degree of economic background or real life experience. As you can see from this representative sample of a major public institution in Virginia, the marketing of college students has shifted from seniors and juniors now to freshman, to even high school students.

I have received quite a few complaints from a Wells Fargo campaign in California, where representatives——

Mr. DAVIS. Let me cut you off for one second, if the Chair will yield me an additional 30 seconds or so.

What is wrong with that? Just from a policy standpoint, in terms of following your analysis, I suspect that the gentlemen on this end, Mr. Wong and Mr. Hildebrand, have the perspective that, well, there is some discrimination in the sense that one class of people are favored over another. But it is not really invidious discrimination. It is discrimination based on favoring people who are likely to be long-term market participants versus those who are not.

I mean, to say that seniors are not targeted, they are obviously not going to be long-term customers. To say that people who aren't in college who are young aren't targeted isn't such a major proposition, I suppose. You are targeting people who are likely to be high-income earners versus people who aren't. I am sure that is the rationale of Mr. Wong and Mr. Hildebrand.

So what is wrong with that? I mean why should we expect this particular market to operate in a more evenhanded way than most markets do in this country?

Mr. MANNING. Well, I think anybody who has found themselves unexpectedly unemployed in this recession would certainly question the expectations of the industry in offering credit to an 18-year-old that their risk assessment model would predict that most of them will get a certain income when they are freshmen, when there is a robust 5 percent unemployment rate, and when they graduate there is an 8 percent unemployment rate, and they are suddenly saddled with $15,000 in credit card debt and $20,000 in student loan debt, with the expectation that they would get a $48,000 job.

Students and people in general assume levels of debt based on their expectations of the future. And students at 18 years old who do not have real life experience, have not had a full time job and have not managed a budget, are making expectations based on a 5 year future, that they don't necessarily have realistic expectations.

Mr. DAVIS. I think my time is expired, Mr. Chairman. Thank you.

Chairman BACHUS. [Presiding.] Thank you.

Mr. Manning, I was reading different things here, but one thing that you said that you might want to propose is to have parents sign off before a college student can have a credit card?

Mr. MANNING. No, what I said was that every student, I think, should have a credit card with a $500 credit limit, unless their parents were willing to cosign for a higher limit, if they were unemployed.

Chairman BACHUS. You know, what strikes me is that it would be a pretty big dose of big government, wouldn't it, telling a large segment of our population that they couldn't have credit above $500?

Mr. MANNING. That is only if they don't have an income. If you look at the credit authorization of college students in the late 1980s, the industry standard was that parents cosigned unless the applicant had a certain income level. I am suggesting that for students that have no income that we should, at least, assure them of a learning curve of a credit card with no more than $500.

Chairman BACHUS. You say parents, unless their parents sign on. You know, some parents refuse to help their children at all while others finance their children's education. So you basically would be taking maybe, let us say you had a young man or woman whose parents either were unwilling to sign on, or weren't willing to help them at all. They might actually benefit from, let's say, $1,000 or $1,500 credit card.

Mr. MANNING. Well, my proposal was one that would increase $500 per year. I was referring to freshmen when they first started college, where by the time they graduated they would have $2,000 in a credit line.

Also, that would not preclude their options for a Federal and private student loan.

Chairman BACHUS. In your book, you are talking about the wide use of credit cards. I notice the Federal Reserve estimates that 50 percent or more of all transactions in the U.S. involve cash. Checks are the second most popular form. And it says that checks total 72 percent of non-cash transactions in the United States. Now this was in 1997, credit cards were 18 percent of non-cash transactions.

Is there any statistical evidence from the Federal Reserve, the FDIC, that youth are having a greater default level today than, say, other than anecdotal, than say 5 or 10 years ago?

Mr. MANNING. Well, that is obviously proprietary information from the industry, and I would be happy to examine it.

Chairman BACHUS. Well, maybe I would ask the industry. Are we having larger default rates this year than we were 5 years ago? And has there been an increase in lending to college students?

Mr. HILDEBRAND. Mr. Chairman, I do not know if we have a higher default rate than we did a few years ago.

I do, however, want to take the opportunity to correct something that Mr. Hendricks said. He implied that most of the marketing to college students was prescreened. As a matter of fact, the only marketing that we do to college students is through prescreening. The only way that a college student can be on a prescreened file from the bureau is if they have already established a credit record.

So these people have, in some way or another, entered the commerce system of America already when we go out to offer them credit.

There are other forms of marketing to college students, tabling, T-shirts, things like that. Capital One does not partake in those. We treat college students and our underwriting of college students the way we treat the general population of America.

Chairman BACHUS. All right.

Mr. HENDRICKS. Just for the record, that is Mr. Manning, and I am Mr. Hendricks.

Mr. HILDEBRAND. I am sorry. I apologize.

Mr. HENDRICKS. We have a mis-merge here.

Mr. HILDEBRAND. I apologize.

Mr. MANNING. I don't think I used the term that most college students are prescreened. I said that there is a policy within which there is a preference given to people of a certain age if they are a college student versus not being a college student.

Chairman BACHUS. Let me ask you this. The FDIC recently said this in their spring 2000 report, that the credit card is one of the best innovations of the 20th Century. Do you all generally agree with that statement?

Mr. MANNING. I would certainly say that the transactional superiority of credit cards in general from a convenience level certainly in the average everyday life has been a great advantage. The problem, of course, is that the cost of using a credit card has increased dramatically, especially for those who can least afford it.

Chairman BACHUS. You are talking about the cost, but here is another: Dr. Thomas Durkin, Federal Reserve Board, Division of

Research and Statistics, this is in a study issued in 2000: "Although one can usually find anecdotes to illustrate a point, consumers who are unaware of the cost of credit cards, for instance, or consumers who overspend because of the wide availability of credit, such examples can never lead to a definitive understanding of issues having broad social and economic impact."

You know anecdotal evidence. Do any of you have statistics one way or the other that we are——

Mr. MANNING. My understanding of that survey was that there were a lot of very critical comments that consumers reported in the use of credit and the cost of credit and the resolution of conflicts, and that there was a real concern about whether that survey instrument was accurately measuring the true criticism the average American has on credit cards, or whether we need a better measurement instrument.

Chairman BACHUS. Well, I guess that is my point. Or are the default rates going up? I think we all agree that there is more credit availability, which is what FCRA has really brought, is availability of credit to a larger number of consumers, easily available credit.

I saw another statistic where loans in low-income areas have gone up 50, 60, 70 percent, to low-income Americans. Lending to borrowers in low-income neighborhoods has gone up significantly since 1993, when we adopted these changes.

Particularly the two gentlemen I think that are representing consumers, do you have any statistical evidence, not anecdotal evidence, but statistical, that we are seeing soaring default rates?

Mr. MANNING. Well, certainly we can look at——

Chairman BACHUS. The interest rates, are they much above what they were, say, 5 years ago?

Mr. MANNING. Well, if you look very clearly at the spread between the cost of borrowing money from the banking industry and the cost that they are loaning out to consumers, that fair share of reduction in costs hasn't been adequately shared with consumers in that benefit.

Chairman BACHUS. Has been shared?

Mr. MANNING. If you look at table four, which is industry data, we see very clearly that the cost of funds went down 28 percent over $7.5 billion between 2000 and 2001, and yet the interest that was charged went down less than 1 percent, even though that the total portfolio only went up 8 percent.

Mr. HENDRICKS. Mr. Chairman?

Chairman BACHUS. Yes?

Mr. HENDRICKS. I didn't come prepared for that, and that is not my area of expertise.

I did try to provide statistics in my statement about what appears to be a dramatic rise in consumer disputes arising from inaccuracies in their credit reports, and some of those are credit report related.

Chairman BACHUS. I apologize. I think, to a certain extent, this is kind of off the issue. There are less than five minutes left on the vote on the House floor.

Mr. TIBERI. Mr. Chairman, can I just make one statement in response to Mr. Manning's comments, the last comments you made, with respect to the credit card industry. I wish my father were here. My father is an immigrant with no formal education of America, sixth-grade Italian education. He has got a credit card that he pays no annual fee on that he uses all the time now. He pays it off every month, and the end of the year he gets money back. He thinks this is a great country because of that.

So it is just bizarre to me that you can kind of paint this stroke about an industry and people who have a lack of education, because my father would tell you he has no education, and he has figured it out, and he is probably a loss leader for the credit card industry.

Mr. MANNING. There are a lot smarter people than me working on marketing campaigns that I can't understand, so I am assuming that most Americans when they read their contracts are at least as uncertain about the consequences as I am.

Mr. TIBERI. Well, Mr. Chairman, with that——

Chairman BACHUS. Thank you.

At this time, we will discharge the second panel.

I very much appreciate your testimony. Your written statements, which we had yesterday, have been very helpful to us. Thank you.

[Whereupon, at 2:20 p.m., the subcommittee was adjourned.]

APPENDIX

June 12, 2003

STATEMENT OF CHAIRMAN SPENCER BACHUS
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
"THE ROLE OF FCRA IN THE CREDIT GRANTING PROCESS"

Good morning. The Subcommittee will come to order. Our hearing today is another installment in the series of hearings the subcommittee is holding with respect to the Fair Credit Reporting Act (FCRA). 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. As I stated last week, my focus throughout this debate will remain on providing consumers and the economy with strong benefits and protections. At our last hearing, we had more than 20 witnesses describe why and how the FCRA is important to consumers and the economy as a whole. Today we will focus on the credit-granting process and the role of FCRA in facilitating the most robust credit market in the world.

The process of applying for a personal loan, car loan, or even a credit card has become increasingly simple. The consumer fills out a brief application, and within a matter of minutes the consumer will know whether he or she has qualified for credit. The chairman of the Federal Trade Commission, Timothy Muris, has referred to this as the "miracle of instant credit." Even the mortgage underwriting process has become much less complicated. Today new homeowners can spend more time picking out new curtains and wallpaper because they spend less time on mortgage paperwork and stress. It should be obvious that these improvements in the credit-granting process benefit consumers.

Our witnesses today will provide us with a complete picture of how the FCRA operates as part of the credit-granting process. Our first panel will focus on how lenders assist millions of

Americans in realizing the dream of homeownership. Just as importantly, we will also learn how a consumer-reporting agency, commonly known as a credit bureau, facilitates the credit-granting process. The first panel will also include witnesses representing consumer groups. Our second panel will review the credit-granting process in a broader scope. We will hear from representatives of a credit union, smaller banks, a large bank, and a credit card issuer. Each will describe how the FCRA affects their ability to make credit widely available to American consumers. We will hear from other witnesses describing some potential pitfalls of the credit-granting process.

I, for one, am particularly interested in how the national standards established by certain provisions of the FCRA relate to the credit-granting process. For example, I am interested in learning whether FCRA has facilitated a national credit market and whether having a national system is beneficial. More importantly, if the national uniformity in place today were replaced with a patchwork quilt of inconsistent state laws, would consumers face a less convenient, and more expensive, credit-granting process?

I want to thank Chairman Oxley, Ranking Member Frank, and Mr. Sanders for working with me on FCRA reauthorization. I believe the bipartisan cooperation that we have had on this important issue has been helpful to the debate. Today we have accommodated all four of the Minority's witness requests.

I look forward to our witnesses' testimony on how the FCRA facilitates the most advanced credit underwriting process in the world, and how it benefits consumers.

The chair now recognizes the Ranking Member of the Subcommittee, Mr. Sanders, for any opening statement he would like to make.

June 12, 2003

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit Hearing entitled, "The Role of FCRA in the Credit Granting Process."

Thank you, Mr. Chairman, for holding this important hearing as part of this series of subcommittee hearings addressing the Fair Credit Reporting Act (FCRA). I would also like to thank you 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.

As we are all now aware, on January 1, 2004 these standards as established in the FCRA will expire and states will again have the ability to enact differing regulations. Extending these uniform federal standards has been endorsed by both Treasury Secretary Snow and Chairman Greenspan, who made his support explicit with these remarks 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."

Today our witnesses will focus on the use of credit reports in the mortgage lending process and other forms of consumer lending. The speed and accessibility of the American mortgage industry has only been able to develop since 1970 and the enactment of the FCRA. The process of prescreening potential customers and extending offers of credit and insurance has also come into existence as a result of the FCRA established uniform national standards. As the Federal Trade Commission (FTC) official, Howard Beales, stated before this subcommittee in our June 4 hearing, "Prescreening, in combination with other direct marketing and advertising, has led to the widespread availability of credit cards with no annual fee and other attractive benefits, and has enhanced competition."

Thank you again, Mr. Chairman, for continuing our dialogue on this issue and I look forward to swift committee action.

OPENING REMARKS FOR THE HONORABLE RUBEN HINOJOSA
HOUSE FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
"THE ROLE OF FCRA IN THE CREDIT GRANTING PROCESS"
JUNE 12, 2004

Chairman Bachus and Ranking Member Sanders,

I want to thank you for holding this third in a series of hearings today to investigate the role of the Fair Credit Reporting Act in the credit granting process. It is necessary that we continue to assess the importance of the national credit reporting system. I look forward to this hearing and the series of hearings this Subcommittee will hold to further clarify the issue.

As I noted at the first hearing, 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.

I have said in the past that one of the main decisions we, as a Committee, needed to make is whether to extend all seven exceptions to the Fair Credit Reporting Act that preempt state law, just some of the exceptions, or none of them. They all expire January 1, 2004.

On June 11, 2003, I and several New Democrats cosigned a letter to Chairman Oxley and Ranking Member Frank looking towards their leadership to ensure that legislation extending the seven expiring provisions of the Fair Credit Reporting Act (FCRA) is passed by the House and Senate before their termination on January 1st of next year.

I believe that these seven provisions enhance the efficiency of the nation's credit system, promote access to the financial industry, protect American consumers, and I am firmly committed to extending them.

However, I also believe it is imperative that any such legislation address problems that have developed since the 1996 enactment of the FCRA amendments. Those issues include, but are not necessarily limited to:

- Identity theft prevention and mitigation;
- The expeditious handling of consumer complaints and disputes;
- Greater accuracy in credit reports; and,
- Consumers' access to their credit information.

I will continue to work with all interested parties to ensure that the final legislation is balanced and fair.

Testimony of

Independent Community Bankers of America
on

"The Role of FCRA in the Credit Granting Process"
before the

Subcommittee on Financial Institutions
and Consumer Credit

of the

Financial Services Committee

of the

United States House of Representatives

June 12, 2003

C.R. (Rusty) Cloutier
President
MidSouth National Bank
Lafayette, Louisiana

and

Chairman
Independent Community Bankers of America
Washington, DC

Mr. Chairman, Ranking member Sanders, and members of the Committee, my name is Rusty Cloutier. I am Chairman of the Independent Community Bankers of America ("ICBA")[1], and President of MidSouth National Bank, a $400 million community bank located in Lafayette, Louisiana. I am pleased to appear today on behalf of the Independent Community Bankers of America to share with you our views on the reauthorization of certain provisions of the Fair Credit Reporting Act ("FCRA"), and The Role of FCRA in the Credit Granting Process.

Community banks have been, and will continue to be, strong guardians of the security and confidentiality of the financial information of their customers. ICBA believes safeguarding customer information is central to maintaining public trust and key to long-term customer retention. Community banks recognize that consumers are concerned about the security of their personal, financial information, especially as technology revolutionizes data collection and retention, and as the incidence of identity theft increases. Accordingly, as a matter of good business practice, and as required by the Gramm-Leach-Bliley Act ("GLBA"), community banks have implemented and upgraded security measures to ensure customer information is properly secured.

REAUTHORIZATION OF FCRA PREEMPTION PROVISIONS

ICBA supports the FCRA uniform national standards that will expire on January 1, 2004, and we strongly urge the Committee to support reauthorizing, or making permanent these provisions. Within the specific context of the FCRA, federal preemption of state laws is essential to ensure consistent, uniform standards. FCRA is an important tool in promoting economic growth, and our credit reporting system plays an important role in the economy. Uniform credit reporting standards also ensure the availability of credit, especially to low and moderate-income borrowers, and helps to maintain the viability of the nation's credit system.

The current law provides for strong consumer benefits, the most important of which are the federal standards that promote fair and accurate credit reporting. If Congress fails to amend FCRA to renew the uniform standards, the current system will be undercut by the enactment of a myriad of state laws with potentially conflicting standards. This will not only result in increased costs to the industry, but it will have a significant impact on a bank's ability to evaluate the credit-worthiness of its customers.

---

[1] ICBA is the primary voice for the nation's community banks, representing some 4,600 institutions with 17,000 locations nationwide. Community banks are independently owned and operated and are characterized by attention to customer service, lower fees and small business, agricultural and consumer lending. ICBA's members hold more than $526 billion in insured deposits, $643 billion in assets and more than $402 billion in loans for consumers, small businesses and farms. For more information visit www.icba.org.

We live in a very mobile society with many consumers often moving frequently, and living in several different cities and states over relatively short periods of time. Additionally, community banks may serve customers in neighboring states, and some allow consumers to apply for credit cards or loans over the Internet. Community banks want clear, consistent policies that allow us to offer choices to our customers.

Currently under FCRA, because we are governed by uniform, national standards, a bank does not have to consider a customer's state or states of residence when reviewing his or her credit report in order to understand what, where, when and how the information was reported. The information in my credit report is reported based on the same federal standards as the information in yours. Community banks rely heavily on the accuracy of this information when making credit decisions. Without federal preemption, and uniform, national standards, information such as loan delinquency, and borrower information reported by the lender to the credit bureau, would be determined by the state. Therefore, a borrower from Louisiana may have a credit report based on different standards, and containing different information, than the credit report of a borrower from Alabama or Mississippi. Further, if the borrower lived in several different states over a period of years, he or she will have a credit report with information reported based on the standards of each of those states. This has the potential to be overwhelming for both the bank and the consumer, and would lead to credit determinations based on state of residence.

The ability of a community bank to serve customers in another state would be negatively affected. We may be forced to charge different prices or charge higher rates. Customers moving into the state would require additional investigation of their credit history to compare it to the standards of their new home state. None of this bodes well for the consumer or the bank. Uniform national standards prevent such confusion and inequalities.

The history of community banking in this country and its success is predicated on the extension of credit. Our current system of extending and granting credit is fair and efficient. In this age of information technology, consumers have grown accustomed to the availability of quick, low-cost credit. The imposition of stricter consumer protections, on a state-by-state basis, will ultimately be to the detriment of the consumer. Banks will be faced with increased marketing costs as a result of compliance with disparate state laws in marketing its products to consumers. Consumers may experience delays in credit decisions, thus impairing access to affordable credit quickly. And banks may lose opportunities to extend consumer credit. Reauthorization of the FCRA uniform provisions will inure to the benefit of consumers as well as community banks.

IDENTITY THEFT

As the nation's fastest growing crime, identity theft resulted in at least $1 billion in losses to banks last year. FCRA plays a major role in fighting identity theft.

Therefore, it is essential that the current nationwide uniformity for reporting consumer credit information is maintained.

ICBA strongly supports measures to thwart identity theft, and to mitigate its impact on customers and banks alike. Strengthening criminal penalties for identity theft, easier consumer access to review their credit reports and correct errors when they occur, appropriate restrictions on who can access information in credit reports, greater consumer awareness of ways to guard their own information and otherwise reduce the risk of identity theft, and better support and assistance for identity theft victims, are all measures that can help reduce the incidence of identity theft, and make it easier for victims to avoid or repair the damage that can result.

ICBA would support measures to allow consumers to obtain a copy of their credit report free of charge annually. The benefit to a community bank in having a customer who has been able to review his credit report at least annually, outweighs the costs associated with lost opportunities for the bank to extend credit due to inaccurate or incorrect credit file information, or identity theft that may take several months to correct. Customers should not have to be faced with a denial of credit before they are able to receive a free credit report. It is in the best interests of everyone to facilitate and encourage consumers to regularly review their credit report.

INFORMATION SHARING

Uniform Notices

The ICBA strongly urges the Committee to maintain an appropriate balance between the critical protection of consumer financial privacy, and the legitimate information sharing needs of community banks to ensure that our customers have access to essential financial products and services. GLBA provisions on consumer financial privacy are the most comprehensive, complex privacy protections ever enacted into Federal law. Privacy notices have followed the mandate of the statute, and its implementing regulations, but have oftentimes proven confusing to consumers. ICBA would welcome development of a form of notice that would be more understandable to consumers and more effective in communicating how consumers can exercise their information sharing options.

Third Party Exceptions

ICBA and its members believe it is critically important to preserve the exceptions in GLBA that permit information sharing with third parties, when necessary, for routine, legitimate purposes. Such exceptions include outsourcing to third parties that perform functions on behalf of the bank, routine processing and servicing of accounts and transactions such as ordering checks, for asset securitization or secondary market sales, and for compliance with the USA PATRIOT Act. Information sharing based on national standards will allow community banks to offer consumers greater access to low cost credit quickly.

Joint Agreements

As the Committee considers the information sharing issue in the context of FCRA reauthorization, it is important to understand that community banks want to avoid additional restrictions on information sharing, like a consumer "opt-in" requirement, because information sharing is essential to how we deliver products and services to our customers. The use of outsourcing, joint agreements, and joint ventures with trusted, long-term partners, is vital to our ability compete, and to offer a full array of financial products and services to adequately serve the needs of our customers, especially those located in rural areas.

The joint agreement business model employed by community banks to deliver financial products and services is analogous to the affiliate model for large banks, and should, therefore, be treated the same. Joint arrangements with other financial institutions should be treated in the same manner as affiliate relationships in order to allow community bank customers a competitive alternative to the products and services available at larger financial institutions. Disparate treatment of information sharing between affiliates, on one hand, and between financial institution joint agreement partners on the other, would unfairly discriminate against community banks because of their relative size and corporate structure.

Opt-In Opt-Out

It is important that the FCRA affiliate sharing language is protected from state regulations. ICBA believes that a consumer "opt-in" option that is being considered in certain states would be detrimental to community banks and their customers. Thus far, the number of consumers *opting out* of having their information shared with affiliates and third parties has been very low, representing 5% or fewer of customers. Therefore, it is likely that opt-in rates will be similarly low. If only 5% of a community bank's customers opt-in to having their information shared with the third parties that deliver that bank's products and services, marketing of those products will be severely hampered.

Opt-in policies would cost us millions of dollars in redesigning and explaining the terms to customers, and in retraining our employees. Customers would be adversely affected as well. Opt-in will result in customers not hearing about new products and services, or their bank not being able to develop and offer the products and services that most meet their needs. The marketing and delivery of products and services will be less efficient, the costs of those services will increase, and customers will be faced with fewer choices and greater inconveniences.

CONCLUSION

FCRA and the nation's credit reporting system help ensure that consumers can easily access competitively priced credit. The reliability of credit information maintained by credit bureaus is critical to this goal. Accurate and complete credit reports can also help prevent identity theft by providing a means to verify a consumer's identity or raise a red flag that additional verification steps should be taken before extending credit or opening an account. FCRA provides for a uniform system throughout the United States by preempting potentially conflicting state laws that could thwart the system's effectiveness in providing rapid access to accurate information. The ICBA strongly urges the Committee to support the permanent reauthorization of the uniform national provisions that will sunset on January 1, 2004.

Thank you for the opportunity to appear before you today. ICBA looks forward to working with you, and at the appropriate time, I will be glad to answer any questions you or members of the Committee may have.

The Premier Association of Real Estate Finance

Mortgage Bankers Association of America
1919 Pennsylvania Avenue, NW
Washington, DC 20006-3438
www.mbaa.org

STATEMENT OF

John A. Courson

Chairman

of the

Mortgage Bankers Association

On

"The Role of FCRA in the Credit Granting Process"

before the

Subcommittee on Financial Institutions and Consumer Credit

Committee on Financial Services

United States House of Representatives

June 12, 2003

Good morning, Mr. Chairman and distinguished members of the Subcommittee. My name is John Courson and I am President and CEO of Central Pacific Mortgage Company, headquartered in Folsom, California. I am also Chairman of the Mortgage Bankers Association of America (MBA)* representing approximately 2,600 companies that are engaged in every aspect of commercial and residential real estate finance and include mortgage companies, mortgage brokers, commercial banks, thrifts, title companies and life insurance companies to name a few.

First, I want to thank you for inviting MBA to participate in this very important discussion. I am proud to testify in this month of June which has been designated by President Bush as Homeownership month. I applaud the Subcommittee for holding these hearings and giving the mortgage finance industry an opportunity to share with you the great success our nation has experienced with respect to the American dream of homeownership due, in part, to the Fair Credit Reporting Act (FCRA). Let me now share with you some of that success.

At present, approximately 68% of all Americans own their own homes, the highest rate in history. More minorities own homes now than ever. Purchasing a home is the largest investment that most Americans will ever make and it becomes their largest asset. Close to 75% of all American homeowners borrow money to finance their home. The Department of Housing and Urban Development indicates that homeownership brings good things to our citizens and to our economy. It creates millions of jobs for American workers; it increases consumer spending as homeowners fill their homes with household items; it is the single greatest contributor to wealth building for families; and it provides economic security for neighborhoods. In addition, homeownership is an important source of income to state and local governments by way of property taxes.

The Fair Credit Reporting Act plays an important role in this success by creating a structure that produces reliable consumer information that is used to lower the cost of homeownership, offer the dream of homeownership to underserved markets, and produce innovative mortgage products. I am here today to ask that you reauthorize the preemptions contained in the FCRA in their current form and maintain the national uniform standard of credit reporting. The national uniform standard is important for consumers and the mortgage industry because it gives rise to the following circumstances:

*MBA is the national association representing the real estate finance industry. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership prospects through increased affordability; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate finance professionals through a wide range of educational programs and technical publications. Its membership of approximately 2,600 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mbaa.org.

- It enables Americans to move to new states and purchase homes with relative ease;
- Lenders are able to originate loans on a national level increasing competition, thereby lowering the cost of credit to consumers;
- Mortgage lenders underwrite loans using automated underwriting systems that provide a quick response to a mortgage application. Automated underwriting systems are facilitated by the national uniform standard of credit. Reprogramming these automated underwriting systems to comply with inconsistent and fragmented state laws will surely increase the cost of credit;
- A mortgage lender can take a successful program or product in one state and implement it in another state allowing those consumers to benefit from it, and
- Credit reports have become reliable measures of an applicant's willingness and ability to pay.

Fair Credit Reporting Act Overview:

The Fair Credit Reporting Act was enacted in 1970 for the purpose of regulating the use and distribution of consumer credit information. It facilitated opportunities for consumers to apply and qualify for credit and for financial service providers to extend credit on a local level. In 1996, Congress amended the FCRA to include seven federal preemptions to provide accuracy, consistency and uniformity among the users of consumer information, those who report consumer information and credit bureaus that collect and distribute consumer credit information. The preemptions, which Congress included on an experimental basis, also provide for consumer protections and recourse to prevent the misuse and inaccurate reporting of consumer information. The federal preemptions improved the credit reporting system by creating a national uniform standard, which facilitated the availability of credit on a national rather than local level. The maintenance of this national uniform standard is imperative to the continued success of the mortgage finance industry by making credit readily available to homebuyers in a timely and cost-efficient manner.

The maintenance of a national uniform standard of credit significantly impacts the success of the U.S. mortgage market, which depends on the operation of the secondary market. Mortgage lenders sell loans to secondary market players who wrap them into mortgage backed securities and sell them to investors. It is imperative to the success of this market that the secondary market entities purchase lenders' loans. Secondary market players use automated underwriting systems to help determine if they will purchase a loan. These systems are statistically based risk management tools that utilize consumer credit information. These systems rely upon a single, national standard of credit and benefit consumers by lowering mortgage loan interest rates and closing costs. If these systems have to be reprogrammed to account for disparate state laws the cost of compliance and the cost of credit will surely increase.

Importance of a National Uniform Standard of Credit Reporting to the Mortgage Industry:

The existence of a national uniform standard of credit reporting increases competition between mortgage companies; allows for the extension of mortgage credit to those traditionally unable to qualify; and facilitates the innovation of mortgage products and significantly shortens the time it takes to close on a home. These benefits extend to consumers, mortgage companies and the economy.

If Congress decides to dismantle this well operating structure, it could negatively affect the availability, costs and variety of mortgage products in this country. Disparate state laws would give rise to regional barriers making it difficult for lenders to operate nationally and, thus, reduce competition among lenders. This outcome would increase the cost of credit to consumers. It would also decrease the amount of available consumer information which is necessary for advancements in technology and the innovation of mortgage products.

A. Consumer Credit Information:

By virtue of the FCRA, the collection and use of consumer information has paved the way for significant advancements in technology. The development of automated underwriting systems has significantly benefited both consumers and the mortgage finance industry. These systems are statistical scoring models that were developed based on information that reveals certain patterns of financial behavior by consumers. A loan officer can take a consumer application and process it through an automated underwriting system from their office. In a matter of minutes, that loan officer can determine whether or not the applicant qualifies for a loan. Borrowers no longer wait up to sixty days to learn whether they qualify for a mortgage loan. These systems are constantly improved and changed as new discoveries about consumer credit behavior are made by virtue of available, complete and accurate consumer credit data. Automated underwriting systems have become a cornerstone of our business processes and consumer information is vital to its maintenance.

The ability to evaluate risk more accurately through analysis of consumer credit data enables us to extend credit to Americans who, under traditional evaluation models, were considered too great a risk. Low income lending was born out of an increased understanding of the financial behavior and risk of consumers in traditionally underserved markets. Loans are made to a higher risk category of loan applicants and the loans carry higher interest rates due to the higher risk of foreclosure. The expansion into this market is growing rapidly from just under $30 million in 1993 to $213 billion in 2002, dramatically increasing total homeownership rates. This expansion was made possible by the availability of consumer credit data.

Low interest rates and competitive low cost mortgage products have created a home buying and refinance boom. The projection for originations for 2003 is over $3 trillion – about 65% of which will be refinanced loans - as compared to 2001 originations of just over $2 trillion in mortgage originations. Currently, some lenders are highly challenged to handle the volume of loan applications. There is no way that the mortgage industry could have accommodated these volumes without automated underwriting systems. Further, these systems would not exist without the availability of consumer credit information.

Consumer credit information also has enabled us to create new mortgage products that are tailored to the needs of certain segments of the population. For example, mortgage products with lower rates in the first few years of the loan's life, appeal to individuals like graduate students who anticipate greater incomes in the future. Understanding consumer behavior enables us to create products that respond to certain consumer needs.

B. Maintenance of a National Uniform Standard:

A national uniform standard of credit reporting is vital to the continued success and ease with which borrowers access credit. As an industry, we have been able to operate on a national level with relative ease due to a single standard of compliance for consumer credit information use, reporting and distribution. Consumers, lenders and the economy have derived considerable benefits from this system. If states are allowed to enact disparate and inconsistent laws in place of a national uniform standard, the cost of credit will increase and the availability of credit will be diminished.

If Congress permits states to legislate in the areas that are preempted in the FCRA, it would have dramatic effects for both industry and consumers. Mortgage lenders that currently operate nationally will be forced to discover and comply with a myriad of state laws that will increase their costs of doing business and, hence, the cost of credit. There would likely be a drop in the number of lenders operating nationally, thereby decreasing competition. Further, the automated underwriting systems that our industry so heavily relies upon are programmed to comply with one set of rules established by the FCRA. If this uniform system were replaced with inconsistent and fragmented state laws, the value and accuracy of the automated underwriting systems would suffer. As a result, there would be increased credit risks for lenders and increased credit costs for consumers.

The existence of a national uniform standard has enabled Americans to obtain credit across state lines with great ease. A consumer can move from their home state of New York to Nevada and buy a house, an automobile, and open a credit card having never been to Nevada. Due to the availability of reliable credit reports, a financial service provider does not need financial experience with a consumer in order to extend credit, but only a copy of their credit report. A consumer credit report also enables consumers to apply and qualify for credit via the internet from out of state lenders.

It is imperative that reliable credit reports be made available to mortgage lenders and financial service providers in general. The credit report is a fundamental tool that permits us to evaluate an applicant's ability and willingness to pay. State laws that make it more difficult to determine the true risk of an applicant would reduce the value and reliability of credit information, thereby increasing the cost of credit.

C. Affiliate Sharing:

Another important part of the national standard relates to affiliate sharing. The FCRA allows consumer information sharing between affiliates of the same corporate family. Through cross-selling products, information is shared with consumers educating them about the availability of certain products that they may be interested in. A customer can take advantage of offers of credit that they would otherwise be unaware of, to improve their financial situation. A customer can exercise the right to opt out of this information sharing and mortgage banking companies take great care in disclosing and honoring this request. Affiliate sharing is an important and inexpensive way for consumers to access credit and for industry to learn about consumers and expand their customer base.

Conclusion:

Many Americans today own their own home and many have refinanced their mortgage. To do so, many American consumers may have responded to an advertised product received in the mail. They may have applied online or sat down with a loan officer, filled out an application and received word within hours about whether their application was accepted. These consumers may have never met the loan officer before and they may have applied in a state to which they just moved. In either case, these consumers were able to buy a home or refinance a mortgage with great speed. Without a national standard established under the Fair Credit Reporting Act, in its current form, this would never have been possible.

I am here today to ask that Congress maintain the national uniform standard of credit reporting for consumers, for lenders and for the economy. By reauthorizing and making permanent the preemptions, the mortgage industry can continue to gather information about consumer credit behavior and utilize it in such a way to offer more Americans the dream of homeownership.

Thank you again for inviting the Mortgage Bankers Association of America to testify before you today. MBA would be happy to furnish you with any additional information you may need. I am happy to answer any questions.

Written Testimony
Of
Allen J. Fishbein
General Counsel
Center for Community Change

BEFORE THE FINANCIAL SERVICES COMMITTEE
Subcommittee on Financial Institutions and Consumer Credit
U.S. House of Representatives

On

"Fair Credit Reporting Act:
How it Functions for Consumers and the Economy"

June 12, 2003

Center for Community Change
1000 Wisconsin Avenue, NW
Washington, DC 20007
202-339-9340
Fax 202- 298-8542
www.communitychange.org

My name is Allen Fishbein. I am General Counsel of the Center for Community Change. I want to thank Chairman Bachus, Rep. Sanders, and other members of the Subcommittee for inviting me to testify today at this hearing on the *"Fair Credit Reporting Act: How it Functions for Consumers and the Economy."* My testimony will focus this morning on issues pertaining to the impact of credit scoring and automated underwriting in providing fair access to mortgage credit.

The Center for Community Change (CCC) is a national, non-profit organization, headquartered in Washington, D.C. For over 35 years, CCC has been an important source of technical assistance, training, and advocacy on behalf of local community organizations working to improve the conditions in low-income and predominately minority communities across the nation. A key component of our work has been devoted to assisting local efforts across the nation aimed improving the flow of responsible mortgage credit to families living in underserved neighborhoods. CCC also released a national study last year entitled, *"Risk or Race: Racial Disparities and the Subprime Refinance Market,"* (www.communitychange.org) that details the disproportionate rise of subprime mortgage lending to minority households and neighborhoods.

My own work in this area spans over twenty-five years in providing technical assistance to local groups and advising lenders and government regulators. I also served for at time as Senior Advisor to HUD for Government Sponsored Enterprises Oversight and on several advisory bodies relevant to today's hearing, including the Federal Reserve Board's Consumer Advisory Council, the Fannie Mae Housing Impact Advisory Council and the Freddie Mac Affordable Housing Advisory Council.

In 1969, during the debate on the original Fair Credit Reporting Act (FCRA), Sen. William Proxmire spoke of the congressional intent behind the law: "The aim of (FCRA) is to see that the credit report system serves the consumer as well as the industry. The consumer has a right to information which is accurate; he has a right to correct inaccurate or misleading information, (and) he has a right to know when inaccurate information is entered into his file . . . The Fair Credit Reporting Act seeks to secure these rights."

Referring to this legislative intent, William N. Lund, with Maine's Office of Consumer Credit Regulation stated last year, " . . . just as the FCRA de-mystified the storage and use of credit information, credit scoring is now serving to re-mystify that process."

I share the regulator's concern. The rapid growths in the use of credit scoring and related technologies have worked to improve access to credit for many, particularly in mortgage lending. However, it also has added an additional veil of secrecy over the credit decision-making process. This veil has created uncertainty and suspicions among consumers about the role that these scoring technologies play as gatekeepers for obtaining credit. Lifting this veil, particularly in the mortgage lending arena is long overdue, but it is likely to require Congressional action to achieve.

What is credit scoring?

Credit scoring is an underwriting tool used to evaluate the creditworthiness of prospective borrowers. Credit scores are statistically derived measures of creditworthiness that seek to rank credit applicants according to their degree of credit or default risk. In essence, the score represents an odds ratio: how many applicants are likely to become delinquent or default at the corresponding score. Used for many years to underwrite certain forms of consumer credit, scoring has migrated in recent years to other forms of credit, such as mortgage and small business lending.

People with high credit scores may qualify for the cheapest credit on the best terms. Too many negative records and/or too few positive records can add up to a low score. Credit scores are widely used among credit card companies to determine the rates and terms of credit cards. Banks use credit scores to determine who can open checking accounts. Credit scoring is used by virtually all car insurance companies and the vast majority of homeowners insurance companies in determining the type and cost of insurance that will be made available to the applicant. It is even used in some situations to make decisions about whether to offer an individual a job, an apartment, or utility service. Credit scores are believed to be a determining factor in 90 percent of all consumer credit decisions. In short, a person's credit score has become fundamental to successes accessing credit and other financial resources.

Credit scoring and mortgage lending

The advent of credit scoring for mortgage lending occurred very quickly. Up until the mid-1990s, when a family wanted to obtain a home loan they typically went into a financial institution to apply for a mortgage. A loan officer would gather information about the potential borrower and the property for which the family was seeking financing and then make the final judgment about whether or not to make the loan. This process could last weeks.

Credit scoring is now used by most mortgage lenders as a key-underwriting tool to determine the credit worthiness of prospective borrowers. It is estimated that 60-70 percent of all home mortgage loan decisions involves the use of credit scoring in the approval process. In today's market, credit scores are used not just to determine whether an applicant qualifies for a mortgage, but also to determine the size of the loan, and increasingly, to set the interest rate and terms the borrower will be charged.

"FICO" is the most commonly used type of scoring in the mortgage market. It is devised by the California-based Fair, Isaac and Co., which provides the scoring analytics. The score is produced for lenders by running a consumer's raw credit-bureau data through proprietary statistical modeling software marketed by the company. FICO scores range from 300 on the low side to 800 on the high side. The score is not actually generated by the lender (many lenders are unable to explain much to borrowers about how their score was derived). Instead the lender requests it as part of the credit report it obtains from one of the three national credit-reporting agencies (bureaus). Each bureau has proprietary components of their models that generate unique scores, and consequently, consumers can have more than one credit score.

Five areas of information are gathered from credit reports and used to calculate credit scores: previous payment history, amount of money owed, length of credit history, amount of new credit sought, and the mix of types of credit. The FICO model also allows users of their model to weigh each variable differently. Thus, some lenders may choose to customize the model they use. The credit bureaus emphasize that their scores are snapshots of a borrower's credit history at the time the score is generated. Scores are regularly updated and therefore, a consumer's score is, theoretically at least, always changing.

Another key development that changed mortgage lending is the rise of automated underwriting (AU). AU systems represent the fusion of statistical scoring scoring methods and high tech processing. Previously used in credit cards and auto lending, proprietary automated underwriting systems developed by Fannie Mae, Freddie Mac, the two government sponsored housing enterprises (GSEs), along with several large mortgage insurers and mortgage lenders are now used for home loan purposes. The GSEs' AU systems are also used by the U.S. Department of Housing and Urban Development (HUD) for FHA lending approvals, although the department is expected to unveil its own AU system at some point. Through the emergence of these systems and the scores they provide, a relatively small number of companies, some public chartered and some not, have a great deal of say in determining who qualifies for prime mortgage credit and who does not.

The AU systems can quickly evaluate mortgage applicants based on information in credit reports as one component of broader mortgage score. Mortgage scores quantify many aspects of risk associated with a particular application – including loan to value ratio, borrower characteristics, and loan type, in addition to credit history. A mortgage lender can submit a mortgage application to AU prior to approving the loan and receive a quick indication as to whether the secondary market will purchase the loan.

Officials at Fannie Mae and Freddie Mac believe that their systems vastly improve their ability to rank borrower risk and to determine eligibility standards for loan purchases. Both GSEs launched their systems in the mid-1990s and they quickly replaced the traditional manual approach to making loan decisions. Because they purchase such a high share of all mortgages underwritten, most mortgage lenders are influenced by the standards set by GSEs' AU systems, even if they choose to hold these loans in portfolio. The GSEs point to how the efficiencies achieved through AU has translated into increasingly higher acceptance rates as evidence that these systems are expanding opportunities for approval of more marginal, yet creditworthy, applications. Some observers believe that recent gains in homeownership rates for underserved segments of our population can be attributed, at least in part, to the underwriting standards that have emerged as a result of the AU systems now in place. But no one outside the purveyors of these systems can say for sure.

The Fannie Mae AU system is known as Desktop Underwriter; the Freddie Mac version is known as Loan Prospector. Each system relies on range of indicators, including numerical scores, loan to value ratios and other data submitted by the borrower to calculate a mortgage score. These scores, in effect, represent the willingness to accept the loan application, or to refer it for further review through more costly manual underwriting. However, those customers that do not meet the required minimum cut-off scores are likely to pay a stiff price. If their loan is not approved, the borrower in all likelihood is relegated to the higher cost subprime market. Subprime interest rates, on average, range from two to three interest points higher than those charged for loans approved by the AU systems. Subprime loans also generally entail much higher points and fees for the borrower than do prime loans.

Subprime loans are typically refinancings of existing mortgages and are made disproportionately to lower income, elderly, and minority homeowners. African-Americans homeowners are nearly three times and Latino homeowners almost two times more likely to receive subprime loans than their white counterparts. Thus the stakes are great for borrowers, which reaffirms the importance of ensuring for the accuracy and fairness of the scoring systems that are used for making these loan decisions.

Increasingly, the GSEs and lenders are using risk-based pricing to make loan decisions in both the prime and subprime markets. And in fact, the difference in the cost of credit some someone with a high credit score and someone with a low score can be quite substantial. At current interest rates, for a $100,000 mortgage made for a property in Maryland, an applicant with a credit score in the highest tier (720 or higher) will qualify for a loan with an interest rate of 5.564%, carrying a monthly payment of $572.00. In contrast, an applicant with a credit score in the lowest tier (under 559) will qualify for a loan with an interest rate of 7.945%, carrying a monthly payment of $730. This means that over the life of a 30 year loan, the higher rate will cost the borrower with the lower credit score $56,924 in additional interest payments.

As credit scoring and AU systems are increasingly used to determine the cost of credit (as opposed to access to credit), new questions arise about the relationship between risk and price. Research by Freddie Mac, for example, suggests that many customers in the subprime mortgage market are being charged interest rates that are higher than would be required to cover the risk they pose to their lenders. AU systems permit the GSEs' entry into the higher end of the subprime market, which can reduce costs for borrowers. However, this "expanded approval" comes with a price, applicants that do make the cut-off for prime loans find themselves paying a higher price for their loan.

Questions remain about the validity and accuracy of scoring and the models used for mortgage lending

Fundamental questions remain about the validity and accuracy of scoring systems being used. These questions linger, in no small part, because the systems and the algorithms they use are proprietary, and held closely by the companies that develop them.

For one thing, the accuracy of the credit score generated by any scoring system rests on the quality, consistency, and completeness of the credit information going into the system. A study published last year by the Consumer Federation of America in conjunction with the National Credit Reporting Association looked at credit scores and the information that went into formulating these scores. The study found wide variations in the scores assigned to consumers based on credit information from each of the three major credit repositories. As many as one in three files had a variation in credit score of 50 points or more, and one in twenty had a range of 100 or more points. This led researchers to conclude that one in five consumers is at risk of being mis-classified into the subprime market due to inaccurate information in the credit reports. (CFA/NCRA. 2002. Credit Score Accuracy and Implications for Consumers).

Further, other research has raised concerns about whether certain creditors may manipulate the credit reporting system to prevent competitors from enticing their best customers away. Some lenders have deliberately failed to report current and accurate information about their borrowers to the credit reporting agencies. The consequence for the borrowers involved has been to depress their credit scores falsely and artificially. Information that creditors were gaming the system led federal banking regulators several years ago to take steps to discourage this practice. However, it is not clear whether financial institutions that are not federally regulated continue to engage in this practice.

Issues about the methods used for computing scores have also been raised. For example, some research has found that developing bureau credit-scoring models through national population samples may omit potentially important variable relating to local and regional economic conditions. The study suggests that credit scores calculated from samples not adjusted for local and regional economic conditions could result in inaccurate credit scores.

Moreover, other important methodological issues regarding the accuracy and fairness of computing scores for mortgage lending purposes still remain. These concerns tend to be of three kinds:

1) Concerns that low-income, minority borrowers, and persons living in older urban areas may be underrepresented in the bureau files. Consequently, the information provided for computing scores may not accurately portray the creditworthiness of underrepresented groups in the applicant pool and thus, may result in inaccurate scores;

2) Concerns that the scoring models used typically omit certain nontraditional indicators of credit performance, such as rent, utility payments, and other non-traditional credit histories which are important components of credit performance for many low-income and disproportionately minority applicants. Conversely, there are also concerns that the models fail to adequately take into account important positives or compensating factors, such as the use of pre-purchase and post-purchase housing counseling which many experts believe can affect projected risk.

3) Concerns that scoring models result in disparate impacts for protected classes and fails to adopt less discriminatory alternative measures. Disparate impact may occur in a credit scoring system when a variable used in the scoring system is facially neutral and applied evenly, but the variable disproportionately adversely affects a segment of the population protected by the fair lending laws (such as racial minorities).

   This point is a particularly sensitive one since all parties – credit score providers, lenders, and the GSEs, quietly acknowledge that racial minorities, on average, have significantly lower credit scores than whites in the scoring models that are employed. In essence, the lower distribution of scores for minorities in means that credit scoring being used today disproportionately rejects minority applicants or means that on the whole they tend to pay more to obtain mortgage credit.

In response to these issues, the credit scoring industry and the proprietors staunchly defend that their systems are predictive of future loan performance and that scoring increases the accuracy of risk assessment. They insist that that they do not explicitly use prohibited factors, such as the borrower's race, ethnicity, age and gender in formulating scores. They point to some research that suggests that scoring can serve the interests of borrowers by expanding credit opportunities for many and improving efficiency of the credit review process.

Nevertheless, the key scoring models used in mortgage lending today, such as the Fair, Isaac & Co. and GSE systems have never been subject to independent verification to ensure that are indeed fair and unbiased and consistent with the nation's fair lending laws. The formulas for these models are closely guarded secrets and therefore, the methodological questions of the type that I have discussed have not been adequately addressed.

Discrimination has been a persistent problem in home finance markets in the United States. To be sure, the mere existence of disparate impact resulting from the application of scoring methodologies does not necessarily constitute the existence of discrimination or illegal treatment. However, given the legacy of lending discrimination, we believe that a high level of scrutiny should be required to ensure that the scoring models used today in mortgage lending are working a manner that is fully consistent with fair lending requirements.

Finally, let me emphasize that my testimony today focuses on the accuracy and fairness of scoring. I do not touch on a host of other real problems that may result from the improper use by creditors of scoring models. These include creditors that do not perform ongoing and effective oversight of the credit scoring model's performance. It also includes improper application of credit scoring models on products, particular subset of applicants, or geographic areas for which they were not developed and the inconsistent use of credit scoring models, including excessive overrides. All of which are real problems that may occur in today's marketplace.

What needs to be done?

De-mystify credit scoring by removing the veil of secrecy that currently pervades this industry.

First, we strongly recommend that Congress mandate the establishment of an effective and meaningful federal agency oversight process of all statistical scoring systems, including automated underwriting systems that are used for mortgage lending purposes. These reviews should be conducted on a regular basis and should focus on the fairness and validity of these systems. The results of these reviews must be released in a timely fashion.

HUD, which has oversight responsibility for Fannie Mae and Freddie Mac, is the only agency we know of that has undertaken a comprehensive review of the automated underwriting systems operated by the GSEs. Unfortunately, the results of this study which were completed more than two years ago is long overdue.

Second, we believe that consumers must have greater access to the scores that are being used to make credit decisions than they have now. Lenders may reveal to a consumer the score that is being used to evaluate their mortgage application, but this is generally too late for the consumer to do much about that score. In response to the California law that requires lenders to give customers a copy of their credit score, Fair, Isaac & Co. reversed its policy several years ago and began selling consumers their own scores. Customers may also obtain their scores from several of the three major credit repositories. Yet there is some question as to whether scores and the scoring model consumers are provided with represents the same ones that a lender may be using at any given time.

Lastly, we concur with the recommendations for improving the credit scoring industry contained in the recent CFA report on credit scoring accuracy. These include the following:

- Require creditors to provide borrowers with a copy of the report resulting in adverse action on a consumer's credit standing.
- Require the automatic re-evaluation of any adverse information resulting in a reduced credit score to determine its accuracy.

- Strengthen requirements for complete and accurate reporting of account information to credit repositories with added oversight and penalties for non-compliance.

In sum, providers of credit scores should be required to share responsibility for ensuring the accuracy of the underlying data, for correcting that data, and for disseminating the correct information if requested by the consumer. Removing the mystery about credit scoring should be on everyone's agenda.

This concludes my testimony. I will be happy to answer any questions that you have.

TransUnion

555 West Adams Street
Chicago, IL 60661
Tel 312 985 3859
Fax 312 466 6815
www.transunion.com

STATEMENT OF HARRY GAMBILL
CHIEF EXECUTIVE OFFICER, TRANSUNION LLC

BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

"THE ROLE OF THE FCRA IN THE CREDIT GRANTING PROCESS"

JUNE 12, 2003

Introduction

Good morning Chairman Bachus, Congressman Sanders, and Members of the Subcommittee. My name is Harry Gambill and I am the Chief Executive Officer of TransUnion LLC. TransUnion is a leading global provider of consumer report information supported by more than 4,100 employees, in more than 24 countries worldwide. I appreciate the opportunity to appear before you today to discuss the role of TransUnion and the Fair Credit Reporting Act ("FCRA") in the credit granting process.

The Role of TransUnion in the Credit Granting Process

Consumer spending makes up approximately two-thirds of the U.S. gross domestic product. A critical component of this economic driver is the availability of consumer credit. Creditworthy consumers in the United States have access to a wide variety of credit from a number of sources at extremely competitive prices. Consumers rely on the availability of credit for a variety of purposes, such as the purchase of homes, cars, education, and daily needs. In fact, there is approximately $7 trillion in outstanding mortgages and other consumer loans in the United States. There is no question that our economy would suffer if consumers could not access credit as they do today.

It is my pleasure to explain how TransUnion plays a critical role in the economic engine of credit underwriting. In sum, we provide the information necessary for lenders to make credit available to consumers. In order for a lender to extend a loan to a consumer, the lender needs to evaluate the risks inherent in lending to that consumer. The proper evaluation of the consumer's risks allows the lender to determine whether to provide credit to the consumer and at what price. We believe that the most accurate and predictive piece of information a lender can use in evaluating a consumer's credit risk is a consumer report (also commonly called a credit report). TransUnion is in the business of providing lenders with this critical information.

The Credit Reporting Process

In order to more fully understand TransUnion's role in the credit granting process, it is important to understand the credit reporting process itself. TransUnion is a consumer reporting agency, or a credit bureau. We act as a nationwide repository of consumer report information with files on approximately 192 million individuals in the United States. The information in our files generally consists of: (i) identification information; (ii) credit history; (iii) public records (*e.g.* tax liens, judgments, etc.); and (iv) a list of entities that have received the consumer's credit report. It is also important to clarify what is not in a credit report. A TransUnion credit report does not include checking or savings account information, medical histories, purchases paid in full with cash or check, business accounts (unless the consumer is personally liable for the debt), criminal histories, or race, gender, religion, or national origin.

Most of the information in our files is provided to us voluntarily by a variety of sources. Although the FCRA does not require anyone to furnish information to credit bureaus, the law does establish certain important guidelines for those who voluntarily do so. For example, furnishers must meet certain accuracy standards when providing information to credit bureaus. Furnishers must also meet requirements ensuring that the information the furnishers have reported to credit bureaus remains complete and accurate. Despite these legal obligations and potential legal liabilities imposed on data furnishers, lenders and others participate in the credit reporting process due to the recognized value of complete and up-to-date credit reporting. In essence, if lenders want accurate, complete, and up-to-date information on which they are to base credit decisions, they must ensure a continuing supply of such data to credit bureaus.

We take great pride in our ability to collect and disseminate credit report information. In fact, TransUnion receives and processes approximately 2 billion updates to consumers' credit files each month. However, we do not distribute credit reports to just anyone. Under the FCRA, we may not provide a credit report to anyone who does not have a permissible purpose for such information. This limitation in the FCRA serves to limit the distribution of credit reports while allowing those with a need for such information (*e.g.* granting credit) to obtain important information.

Case Study: The Role of TransUnion in Assisting Consumers Achieve the Dream of Homeownership

As I have discussed, TransUnion assembles consumer information and provides it, in the form of a credit report, to those who are permitted by law to obtain such information. One such permissible purpose is mortgage lending. I would like to take a moment and use a typical mortgage transaction to illustrate TransUnion's involvement in the credit granting process, the importance of the FCRA, and how consumers benefit.

Picking just the right home is obviously a fundamental part of becoming a homeowner. However, because most consumers cannot afford to purchase a home using cash, it is also important for the consumer to be able to finance the house. I can recall the days when obtaining a mortgage meant going to the local banker and enduring a lengthy application process. But today a consumer has the ability to pick from a plethora of mortgage lenders, regardless of where the consumer lives. In fact, lenders across the country are willing to extend mortgage credit to consumers they have never even met. Lenders are able to compete for consumers in this manner because the lenders can rely on companies such as TransUnion to provide the information necessary to evaluate the creditworthiness of the applicant, even if the lender and applicant have never laid eyes on one another.

The credit reporting process means more than allowing mortgage lenders to compete for consumers (which obviously lowers costs). For most consumers, the existence of three national credit reporting databases means quicker loan decisions by the mortgage underwriter, and the consequent ability to close on the house more quickly. The automated underwriting systems that have been adopted by the industry are enabled by the existence of the national credit reporting databases. For those consumers whose credit histories contain adverse information, or for those with "thinner" histories, the operation of the dispute procedures in Section 611 of the FCRA, together with the verification work done by the so called "reseller" consumer reporting agencies (one of whom testified before this Subcommittee last week), combine to allow all consumers the opportunity to ensure that the credit information on which the mortgage decision, and the mortgage interest rate, are based is accurate and complete.

This system delivers to consumers quick decisions, increased competition, and lower rates. In many other countries, consumers, regardless of their credit profiles, do not have access to long-term mortgages or must pay interest rates of more than 20% on their loans. This is a direct result of the lack of a comprehensive and uniform credit reporting system. It is caused by the absence of credible information being available to all lenders. Unlike consumers in the United States, consumers in those countries do not have many options. They are generally tied to one institution — their bank — for all their financial needs.

<u>The Importance of Nationally Uniform FCRA Provisions to the Credit Granting Process</u>

I have just explained in general terms TransUnion's and the FCRA's role in the credit granting process. Like other consumer reporting agencies, TransUnion obviously plays a pivotal role in the credit granting process in the United States. This credit granting process, which relies heavily on the information and activities regulated by the FCRA, has resulted in more choice and convenience to consumers at lower costs. The following explores some of these benefits and the importance of the FCRA's national standards in fostering such a competitive and diverse credit market.

<u>Predictive Power of Consumer Reports</u>

A consumer report represents a complete, accurate, and up-to-date snapshot of a consumer's financial history. This is important to a lender assessing a consumer's credit risk for several reasons. First, the lender can evaluate the information provided in a consumer report and make a credit decision accordingly. Just as importantly, a lender reviewing a consumer report has a high degree of confidence that the consumer report includes a complete picture of the consumer's financial history. In other words, the lender knows that he or she has a complete understanding of the consumer's financial history and that there is not any material information about the consumer's creditworthiness being hidden. The fact that the consumer report is complete, accurate, and up-to-date allows the lender to make an accurate assessment of the consumer's credit risk.

Furnisher Obligations

The ability of a lender to rely on a consumer report when making credit decisions is preserved, at least in part, through several provisions that establish the FCRA as the national, uniform standard. For example, as I noted above, furnishing information to credit bureaus is completely voluntary. Creditors and others are willing to provide information to credit bureaus because they understand the value of, and benefit from, a robust credit reporting system. Despite the obvious interest most furnishers have to report only accurate and complete information, in 1996 Congress determined that those who furnish information to credit bureaus must have some legal obligations with respect to the accuracy and completeness of information provided to credit bureaus. However, in imposing these obligations, Congress recognized that the data provided to credit bureaus was the lifeblood of the credit reporting and underwriting processes. Therefore, the furnisher obligations represent a careful balancing of the need for accuracy with the need to ensure an uninterrupted flow of information to credit bureaus. The compromise reached in the 1996 amendments, imposing accuracy and completeness obligations on furnishers, enforceable by state and federal agencies, establishes a national standard under the FCRA.

If states were permitted to impose additional obligations or liabilities on furnishers, the viability of the credit reporting process could be threatened. We believe that various state laws with respect to furnisher obligations may discourage entities from providing information to credit bureaus. Indeed, depending on the state law, it may be prudent for furnishers not to provide such information if it would subject the furnisher to unnecessary litigation, including class action liability. If this were to happen, consumer reports would contain less information and become less reliable. In effect, lenders would no longer have confidence that a consumer report represents a complete, accurate, and up-to-date snapshot of the consumer's financial history. In order to compensate for this uncertainty when evaluating the consumer's creditworthiness, lenders may be less willing to provide credit to the consumer, or may do so only at an increased cost.

Contents of Consumer Reports

Just as lenders know that a consumer report is complete because a large number of furnishers provide significant amounts of information, they also know that a consumer report is complete as a result of the uniformity established under the FCRA. The FCRA generally does not allow a consumer reporting agency to report "obsolete" information as part of a consumer report. Obsolete information includes most negative information that is more than seven years old, and bankruptcies that are more than ten years old. The FCRA preempts state law with respect to the contents of consumer reports.

Lenders would have less confidence in consumer reports if a state were permitted to limit the information contained in a consumer report. For example, if a consumer report could only include negative information that is less than four years old, it would be less predictive of a consumer's credit risk than a consumer report that had information dating back to seven years. Furthermore, if a state were permitted to restrict the types of information included in a consumer report (*e.g.* prohibiting the reporting of 30-day payment delinquencies), a lender could be denied important information necessary to evaluate the consumer's credit risk. Again, creditors would respond to this uncertainty either by making less credit available to consumers, or by increasing the cost of credit.

Reinvestigation Timeframes

Among the many rights provided to consumers under the FCRA is the right to challenge the accuracy of consumer report information. We believe this is an important consumer right and it can be useful in making our files more accurate. The FCRA establishes a 30-day timeframe under which a consumer reporting agency must reinvestigate a consumer dispute. If the consumer reporting agency finds that the information is inaccurate, or cannot verify its accuracy within the 30-day period, the information must be deleted. This timeframe is uniform throughout the country. This uniformity is important if consumer report information is to maintain its current level of reliability. If states were permitted to establish differing reinvestigation timeframes, consumer reporting agencies may not have sufficient time to investigate consumer disputes, and national data furnishers would be overwhelmed in complying with the differing reinvestigation turnaround times — creating another incentive to withdraw from full-file voluntary reporting.

Technology offers one solution to speeding reinvestigation times. The 1996 amendments required the national consumer reporting agencies to adopt an automated system for communicating consumer disputes to data furnishers and to the other national agencies.

This system (ACDV) has now been in existence for over five years, and 52% of our data furnishers participate in it. Our goal is 100% participation. Turnaround time for these inquiries is 50% faster, on average, than on the old manual system still in operation.

Aside from the detrimental impact on the accuracy and completeness of consumer reports, we are also concerned that such state laws would unintentionally open the door for fraudulent "credit repair" clinics to attempt to overwhelm credit bureaus with reinvestigation requests with the hope that the consumer reporting agency will not have the resources to complete all of the investigations within the shorter timeframe established by the state. We estimate that 35% of our dispute volume comes from credit repair clinics. Our experience is that these clinics cost consumers thousands of dollars, clog the dispute process for all consumers and rarely result in any material change to the consumer's credit report.

Consumer Notice

In order for the consumer reporting process to work well, consumers must know what their rights are under the FCRA. Furthermore, each consumer must have the ability to learn about the contents of his or her consumer report, how to be more "creditwise," and how to verify the accuracy of their credit report. Just as importantly, each consumer should be made aware when information in his or her consumer report results in a denial of credit. There are several provisions in the FCRA which establish a national uniform standard with respect to consumer notice.

Consumer Disclosures

The FCRA requires a consumer reporting agency to provide a consumer with a summary of his or her rights under the FCRA with each written disclosure of a consumer report to the consumer. The Federal Trade Commission has provided consumer reporting agencies with model language that can be used to comply with this important requirement. The form and content of this disclosure is uniform across the country under the FCRA.

We believe that this uniform standard is important if consumer reporting agencies are to provide meaningful disclosures to consumers about their rights under the FCRA. Under current law, consumer reporting agencies can provide clear and succinct disclosures to consumers regarding their rights. We do not believe states should be permitted to adjust the form and content of the notices describing the consumer's rights *under federal law.* Furthermore, if states begin to deviate from the Federal Trade Commission's model, the disclosures likely would become more complicated for consumers. For example, the consumer may have an address on file in several different states, forcing the consumer reporting agency to provide several different disclosures to the consumer. This may result in confusion to the consumer. Alternatively, the sheer amount of verbiage in the multiple disclosures may *discourage* the consumer from reading any of the important information.

Voluntary Efforts

In addition to our compliance with the FCRA's consumer disclosure requirements, we have established specialized staff and procedures in our Consumer Relations department to assist identity theft victims — which include individual consumers and our customers — to recover from identity fraud and prevention of future victimization. We also voluntarily provide a credit score disclosure for a nominal fee to consumers who request one. Today, through our web site www.transunion.com and the web sites of our affiliated companies we provide information on consumer rights, credit scoring, identity theft, opting out of prescreened and direct marketing offers, and managing credit.

TransUnion's ability to provide useful and consistent consumer education is preserved, at least to some degree, by the provisions in the FCRA that establish national standards. Millions of Americans move to different states each year. Millions of others maintain residences or office addresses in more than one state. A great deal of these consumers maintain credit relationships associated with each of these addresses. The fragmentation of rights, policies, and procedures in these areas which would result from differing state laws would increase the complexity of the system and diminish, not enhance, most consumers' understanding of their rights and their ability to secure them.

Consider the person who has recently moved, or maintains addresses in different jurisdictions. If states were permitted to alter key provisions in the FCRA, such as reinvestigation timeframes or the contents of a consumer report, TransUnion would have a very difficult time providing the consumer with the appropriate education regarding his or her rights as they pertain to the credit reporting process. Uniformity is vital if people are to understand the rules of the game. For the national consumer reporting agencies to fulfill their educational and empowering role in explaining consumer rights and the operation of the credit reporting system, it is critical that the system indeed be national and uniform.

Adverse Action Notices

The credit granting process provides another mechanism for a consumer to be informed of his or her rights. Each consumer who is denied credit due to information contained in his or her consumer report must receive an "adverse action" notice under the FCRA. Adverse action notices inform the consumer of, among other things: (i) the consumer reporting agency that provided the consumer report to the creditor; (ii) information on how to contact that consumer reporting agency; and (iii) the fact that the consumer may obtain a free copy of his or her consumer report from that consumer reporting agency and dispute any information contained in the report. These adverse action responsibilities are uniform throughout the country, and serve as an important tool in notifying consumers of potential errors in their consumer report.

It is important to maintain the national uniformity with respect to adverse action requirements for the same reasons discussed above pertaining to the disclosure requirements imposed on consumer reporting agencies. If consumers are to receive a meaningful disclosure, it must be succinct and uniform throughout the country. Additional requirements imposed by a state would simply dilute the important information conveyed in adverse action notices.

Improved Underwriting Process

Prescreening

Prescreening is a process by which a creditor (or an insurer) must provide a firm offer of credit (or insurance) to consumers who meet the eligibility standards for the prescreened credit (or insurance). For example, a creditor may obtain from a credit reporting agency a list of consumers who meet certain prespecified underwriting criteria. The creditor must make a firm offer of credit to each consumer on the list and provide credit to each consumer who responds, assuming the consumer continues to meet the terms of the offer. There is no question that prescreening has allowed creditors to compete for consumers across the country, which has reduced the cost of credit and increased the credit choices available to consumers. However, prescreening also serves as an important tool for creditors in their efforts to manage their portfolios. By specifically targeting consumers that meet certain lending criteria, creditors are better able to control their credit risks. Indeed, we understand that losses associated with accounts obtained through prescreening are generally less than losses associated with accounts obtained through other means.

Affiliate Sharing

The ability of affiliates to share information among themselves can be an important component of a creditor managing the credit risk of its portfolio. Not surprisingly, the value of affiliate sharing in the underwriting context has been noted by the federal banking agencies. The agencies, in draft guidance that was released to those in the lending community, recommended that financial institutions use affiliate sharing to better monitor consumer activity across business lines in order to prevent an over-extension of credit to individual consumers. In this regard, affiliate sharing helps creditors operate in a safe and sound manner and reduce chargeoffs. The end result is the opportunity for lower costs to consumers.

The Importance of Nationally Uniform FCRA Provisions in Identity Theft Prevention and Resolution

TransUnion Is Part of the Solution

Since the 1980s, when TransUnion developed the first application fraud detection suite of services for credit grantors (our HAWK® products, introduced in 1983), we have been helping our customers detect and avoid application fraud, thus reducing the number of consumers affected by identity theft. In the mid-1980s we began development of special procedures to assist identity theft victims, including expedited dispute verification processes (and deletion of fraudulent information) and the innovation, in 1989-1990, of a "security alert" flag on credit reports, to alert our customers to use extra caution in opening new accounts. In 1992, we formally established a special Fraud Victim Assistance group within our Consumer Relations Department. In the late 1990s, we began immediate suppression, at the same time the dispute investigation process was initiated, of fraud-related information on a consumer's file upon their presentation of a police report or other documentation confirming the fraud. In March 2000, this process became an industry standard. Two years later, the industry noted that the majority of contacts to the national consumer reporting agencies' toll-free phone numbers are preventative — from consumers concerned about possible fraud rather than identity theft victims. (See attached Consumer Data Industry Association announcement of March 20, 2002.) Our identity fraud specialists work with consumers, industry and government agencies to remediate damaged credit files as quickly as possible, to take preventive steps that reduce further victimization, and to cooperate with law enforcement authorities in their investigations and prosecutions of this crime.

The Importance of National Standards

Furnisher Obligations

As discussed above, state laws pertaining to furnisher obligations may reduce the number of entities willing to provide information to consumer reporting agencies. Withdrawal of data furnishers from the system will result not only in a loss of the credit information they provide but will also result in the loss of the address updates they provide. TransUnion's database relies on addresses that are in active use by creditors in mailing monthly statements to their customers. The fact that most data furnishers today also provide us with the social security number of their customers allows us to bridge address changes and name variations. Businesses and government agencies with a permissible purpose to obtain a consumer report rely on our robust national database of names and up to date addresses for a variety of fraud prevention and identity authentication services. If there is less current identification or address information coming into the database, the performance of these services will suffer.

Reinvestigation Timeframes

Consumer reporting agencies play an important role as part of the solution to identity theft. In essence, the consumer reporting agency is tasked with sorting out accurate information about the consumer, and maintaining it, while deleting any information from the credit file that may be the result of an identity theft. We at TransUnion believe that the national 30-day reinvestigation timeframe allows us the opportunity to establish a *single* reinvestigation process that treats all consumers fairly. As the Subcommittee knows, reports of identity theft are on the rise. TransUnion works closely with consumers to resolve these claims. However, these claims can be complex and require significant resources. We believe it is difficult enough to resolve these disputes correctly under the system permitted by a single federal law. The difficulty in correctly resolving identity theft claims if we had to operate under systems established by dozens of state laws would be even more difficult.

Prescreening

In addition to providing creditors with the opportunity to manage their credit risk, prescreening also gives creditors the ability to better manage their fraud risk, including fraud as a result of identity theft. We understand that fraud associated with prescreened applications is much less than fraud associated with accounts acquired through other means. Indeed, a witness from a prior hearing noted that their fraud losses associated with prescreened accounts are one-seventh the fraud losses associated with accounts obtained through other means.

Affiliate Sharing

It is our understanding that creditors are making more use of information obtained through affiliate sharing to complement the consumer reports they obtain from consumer reporting agencies in order to prevent identity theft. For example, a creditor may detect a possible case of identity theft if that creditor detects a discrepancy between information on the credit application and information maintained by an affiliate with the same individual (*e.g.* the social security number does not match up).

The Use of Credit Reports in the Credit Granting Process: Accuracy in Credit Reporting

Throughout my testimony I have referred to how lenders rely on our products in order to make sound lending decisions. A fundamental assumption in this discussion is that the information we provide to lenders is accurate. I would like to take a moment to discuss why we believe our customers can rely on the accuracy of a TransUnion consumer report.

TransUnion has a legal obligation under the FCRA to "follow reasonable procedures to assure maximum possible accuracy of the information" in consumer reports. These include the development of customized programs to pre-process the incoming monthly updates from data furnishers, to monitor the flow of data, and assure its correct conversion into our database. We vet all data furnishers, as we do any potential subscriber who wants to purchase credit reports to ensure that they are a legitimate business, and that they understand and will comply with their duties under the FCRA. Data furnishers are required by the FCRA to adhere to certain accuracy and completeness standards. In addition, *every consumer* has the ability under the FCRA to obtain his or her consumer report and dispute the accuracy of any information on the consumer report. Indeed, those consumers who are denied credit are encouraged to verify the accuracy of their consumer reports as a result of the adverse action notices.

I should also note that the consumer reporting process is highly competitive. TransUnion competes with several other providers of consumer report information, and we strive to provide our customers with the most complete, accurate, and up-to-date information available. If our information were not accurate, our customers could take their business elsewhere.

We also believe that a common sense review of the status quo suggests that our information, on the whole, is extremely accurate. As this Subcommittee has heard, the ability of lenders to provide credit to consumers is predicated on the availability of accurate, complete, and up-to-date information, usually in the form of a credit report. We have the most robust credit market in the world, with millions of decisions being made on a daily basis as a result of information contained in credit reports. It is unlikely that the credit market in the United States would be the success story that it is today without having reliable consumer report information.

Aside from these obvious considerations, we believe the general accuracy of consumer report information has been validated in many ways. For example, TransUnion customers use diverse and usually confidential means of evaluating accuracy and completeness. Effectiveness (in terms of predictive power) of the consumer reports, system access and reliability, and completeness of credit information are all seen as factors. Over the years, our customers continue to affirm the accuracy of our national database in predicting a wide variety of outcomes — including future account delinquency, future bankruptcy, and likelihood of insurance claims.

The Role of Credit Scoring in the Credit Granting Process

The emergence in the late 1980s of uniform, national credit reporting databases such as TransUnion's enabled development of robust national models developed to predict a variety of outcomes — from account delinquency to insurance losses. As a group, these models provide a level of accuracy and scalability with respect to risk assessment previously unavailable to financial institutions.

The provisions of FCRA for notice of adverse actions and correction of erroneous information provides consumers with important tools to ensure that a credit score is based on accurate information, including the identification of the principal factors within the model that negatively affected the score. By 2000, the growing use of models — and notably their adoption by Fannie Mae and Freddie Mac for use in mortgage underwriting — led to increasing, and understandable, demands for more transparency in their use.

In April 2001, TransUnion announced our intention to provide, upon request, a score disclosure with our consumer file disclosures. Today, we continue to make available upon request for a small fee our proprietary TransRisk® score, which is used by some lenders in making credit granting decisions. Other companies, including the other two national consumer reporting agencies, provide similar disclosures and educational tools.

As this Subcommittee considers issues pertaining to the FCRA, it is likely that credit scores will be debated. I would like to offer the following observations that may be helpful in this regard. Credit scores are simply a numeric representation of any one person's assessment of the risk presented by a consumer. There are hundreds of credit-based scoring models in use, some commercially available directly from the consumer reporting agencies, and many others are proprietary models owned by individual financial institutions. These proprietary models typically leverage the technology available in the models developed by consumer reporting agencies and apply additional, specialized logic unique to that financial institution. Development and maintenance of these models is expensive. Their effective performance is quite properly viewed as critical to the institution's competitive success and soundness. Just as other companies are not required to divulge their trade secrets, TransUnion and others should not be required to disclose our proprietary models used to evaluate risk.

Free File Disclosures to Consumers

The issue of free file disclosures has been considered and rejected in past Congresses. Our view is that the FCRA already strikes a liberal balance favoring free disclosures in most of the circumstances in which consumers have occasion to interact with the consumer credit reporting system. Moreover, enactment of a federal free annual disclosure standard could, in our view, seriously threaten our economic viability.

The FCRA provides for free file disclosures to consumers if the consumer: (i) is the subject of adverse action; (ii) is unemployed and intends to apply for employment; (iii) is on public welfare assistance; (iv) has reason to believe the file contains inaccurate information due to fraud; or (v) will be a subject to an adverse employment decision. In TransUnion's 33 years of operations under the FCRA, the vast majority of consumer disclosures have been without charge, in compliance with these provisions. For those that do not qualify for the free file disclosures, the price of consumer reports is capped by law at a reasonable cost (currently $9).

Further, security breaches already seriously impact us through the FCRA's fraud exemption. A person who believes there may be fraudulent data in his or her file is entitled to a free disclosure. In the past two years, security breaches at the State of California's employee database and at Tri-West (a Department of Defense subcontractor in Arizona) caused those affected to flood our consumer relations department with requests for file disclosures. In both of these cases, we provided disclosures at no charge. We are very concerned, however, about the harm to consumers and also the cost implications of this trend.

The harm to consumers comes in the form of slowed response time. In the State of California case, there were 186,000 state employee records compromised. All of these individuals received notice of the breach from the state instructing them to contact the consumer reporting agencies. Many did so, flooding our service centers. Consumers with ordinary inquiries, pursuant to an adverse action notice, or proactively anticipating a mortgage loan process, saw their response times suffer as this massive number of inquiries from the breach worked their way through the system.

To the extent the practice of providing affirmative notice on any breach of personal information grows we may be exposed to uncontrollable increases in our costs. In both the California and Tri-West cases, the breaches had nothing to do with credit information, but we are the ones consumers contact to check their information and post a security alert.

We believe that the FCRA ensures that free file disclosures are available for those most in need of reviewing their consumer report. However, entitling 200 million people to our product at no charge is not, in our view, appropriate. We believe that capping the cost of a consumer report is more appropriate than a free file disclosure. Many *public* sector entities charge a reasonable fee to obtain information that the government maintains about individuals. For example, a consumer seeking to obtain information from the Federal Bureau of Investigation or the local department of motor vehicles will be required to pay a modest fee for the information. The government's ability to recoup the cost incurred to provide consumers with this service is appropriate. As a private sector entity, our ability to recover these costs is not only appropriate, it is essential.

Consumer reporting agencies will be forced to recoup the expenses associated with a free file disclosure. These expenses will be shouldered by us as well as our customers — the institutions that rely on consumer report information to grant credit to consumers. The additional costs incurred by creditors and others will likely be passed on to consumers in the form of additional costs for credit.

Conclusion

TransUnion plays a critical role in the credit granting process. Indeed, we are a fundamental component of the most robust credit market in the world. The benefits to consumers are more convenient options for credit at lower costs. For example, our system, which is based on complete, accurate, and up-to-date consumer report information, has helped millions of Americans reach the dream of homeownership.

Critical to the system is the national uniformity that has been established in several key areas governed by the FCRA. A single uniform standard with respect to furnisher obligations, adverse action, reinvestigation timeframes, the contents of consumer reports, prescreening, affiliate sharing, and consumer disclosures has helped foster the success story known as the American credit granting process. We believe these uniform provisions are useful for other reasons, as well, such as for the prevention and resolution of identity theft.

Mr. Chairman, Congressman Sanders, and members of the Subcommittee, I sincerely appreciate your invitation to testify today. At TransUnion, we are deeply concerned about the potential impact of allowing the states to enact a patchwork of inconsistent laws. I am gratified that my schedule allowed me to be here today in order to personally present our views to you, and I would be happy to answer any questions, or provide further information that the Subcommittee may request.

Attachment: CDIA March 20, 2002 Press Release

CDIA
CONSUMER DATA INDUSTRY ASSOCIATION
Empowering Economic Opportunity

NEWS RELEASE

Contact: Norm Magnuson

Vice President of Public Affairs

202/408-7406

March 20, 2002

INDUSTRY INITIATIVES, EDUCATION MAKING AN IMPACT ON ID FRAUD

LAW ENFORCEMENT IS CRITICAL

The nation's largest credit reporting systems' data shows that the majority of consumers who call their toll-free fraud numbers are doing so as a precautionary measure and not as ID Fraud victims, reported the Consumer Data Industry Association. Further, the Federal Trade Commission's own ID Theft Clearinghouse data shows that fully 42 percent of crime victims who contact the FTC learned of the crime in less than a month.

"This is the data we've all been hoping to see and it shows that our educational efforts are working. Crime victims are taking actions sooner and more consumers are taking the steps necessary to avoid being crime victims in the first place", said D. Barry Connelly, president of CDIA. "We have to stay the course and continue our educational outreach," he added.

Connelly went on to applaud Equifax, Experian and TransUnion for their adoption of key ID Fraud victim assistance initiatives. "We didn't need a new law to act as our moral compass," he noted. CDIA has had standing task forces on high-tech fraud issues since the early nineties. A specialized ID fraud task force was established in 1998 and on March 16, 2000, CDIA announced its first six-point program for victims. By January 1, 2001, the CDIA's members were already providing nationwide voluntary victim assistance services. These voluntary initiatives pre-date recent Congressional proposals and they include:

- Using fraud alerts on credit reports transmitted to creditors helping them to avoid opening additional fraudulent accounts.
- Standardizing fraud alerts nationwide so that all creditors can recognize them.
- Expediting the removal of fraudulent data for victims who have police reports.
- Assisting ID fraud victims by notifying creditors and others when the consumer does not recognize recent credit file inquiries by other lenders.
- After receiving a call on the industry toll-free number, fraud center personnel add a security alert to the credit file, opt the victim out of prescreened credit offers and send a copy of the credit report to the consumer within three business days.
- Maintaining contact with victims for 90 days after the file has been corrected to ensure that no new criminal activity results in fraudulent data.

Connelly also recognized the General Accounting Office for their efforts in trying to quantify the crime of identity fraud. He noted that prior to the GAO's March 7 report, there was no definitive data on the size of the crime. "The GAO put real numbers behind the issue of identity fraud. But even though these numbers are lower than the figures often cited in the media, if you take one of the higher figures cited in the report, 92,000 victims a year is still too many and our industry will continue in its efforts to assist consumers who are victims of this crime, " he said

The key to any successful attempt to reduce ID fraud is the role played by law enforcement. Connelly encouraged Congress to approve additional funding to help law enforcement track down and prosecute those who prey on consumers. "The resources in the law enforcement community are already stretched too thin. If we really are serious about attacking the root causes of this crime, then we need to support the police in their efforts. Additional personnel and money directed at this crime will further reduce its numbers", said Connelly.

That brings into question the wisdom of passing additional legislation to address the issue of ID fraud noted Connelly. "Industry initiatives have been launched, consumer education efforts are ongoing, and only a greater emphasis on assisting law enforcement will reduce identity fraud.", Connelly concluded.

############

PRIVACY TIMES

EDITOR: EVAN HENDRICKS

Testimony of

Evan Hendricks, Editor/Publisher
Privacy Times
www.privacytimes.com

Before The House Committee On Financial Services
Subcommittee on Financial Institutions & Consumer Credit
June 12, 2003

Mr. Chairman, thank you for the opportunity to testify before the Subcommittee. My name is Evan Hendricks, Editor & Publisher of *Privacy Times*, a Washington newsletter since 1981. For the past 23 years, I have studied, reported on and published on a wide range of privacy issues, including credit, medical, employment, Internet, communications and government records. I have authored books about privacy and the Freedom of Information Act. I have served as an expert witness in Fair Credit Reporting Act and identity theft litigation, and as an expert consultant for government agencies and corporations.

I was closely involved in the six-year process that resulted in the 1996 Amendments to the Fair Credit Reporting Act. An important lesson to be drawn from that exercise is that the best way to improve our national credit reporting system is to strengthen protections for consumers. The more power that consumers have to maintain reasonable control over their credit reports, the better the chances for improving their accuracy and ensuring they will be used fairly and only for permissible purposes.

The 1996 Amendments aimed to address several problems, including chronic inaccuracy, non-responsiveness and inadequate reinvestigations by consumer reporting agencies (CRAs) and furnishers, the reinsertion of previously deleted data and the impermissible use of credit reports. Congress recognized that the evolution of a reporting system that became more national and scope and more automated also necessitated a legal evolution that would further empower consumers to be the guardians of their own data. Congress has always recognized that the States play an important role in advancing consumer protection, both through enforcement and innovative legislation.

The record is clear that credit report inaccuracy, inadequate reinvestigations, CRA and furnisher non-responsiveness, reinsertion and impermissible use persist to this day as serious problems that are damaging to consumers and the credit reporting system itself. Moreover, our laws for protecting the privacy of financial data not covered by the FCRA are woefully inadequate. Thus, it is imperative that Congress further strengthens the FCRA and national financial privacy laws, and gives the States more freedom to act in ways that are consistent with the overall national goal of protecting consumer privacy.

The unfortunate reality under the current system for many consumers who are victims of inaccurate credit reports and/or identity theft is that they can only force CRAs and furnishers to truly reinvestigate and correct errors by filing a lawsuit. I have seen cases in which consumers followed all the normal procedures to get errors corrected, only to find that inaccurate information was "verified" as reported, or previously deleted information was reinserted. In these cases, the procedures of CRAs and furnishers were simply unable to achieve accuracy.

As I will detail in this statement, the market forces (i.e., the high volume of disputes and cost of personnel) has created a regime that is tolerating significant, and probably unacceptable, levels of inaccuracy. For those consumers, this creates a corresponding chain of damages. It also raises serious questions about the accuracy and integrity of the data in the national credit reporting system.

In fact, the CRAs, as a matter of policy, give priority treatment for people that have filed suit or have threatened to sue. In my opinion, CRAs have calculated that it costs less to fend off the occasional lawsuit than to invest the resources necessary to prevent the problems that caused credit report inaccuracies to become the leading cause of complaints to the FTC in 1991-93. The CRAs are probably correct. Filing suit under the FCRA is a daunting and arduous task, due to the enormous discovery challenges and defense litigation tactics. There is only a small community of plaintiffs' attorneys that specialize in the area. I have spoken with consumers that could not on their own find an attorney to represent them.

The 1996 Amendments attempted to preclude the need for litigation by specifying a higher standard of care for CRAs, furnishers and users of credit reports. We need to recognize the reality that the Amendments have not achieved their goal and that in too many instances consumers who want to protect their good name must sue.

Considering that CRAs keep records on some 190 million Americans, we also must recognize that we will never be able to build a bureaucracy big enough to enforce Americans' right to credit report accuracy and privacy. Therefore, it is necessary to "popularize" enforcement by strengthening individuals' authority to protect their own rights.

We discovered in 1970 that the advent of a national credit reporting system posed significant threats to privacy and fairness, and we enacted the FCRA. In the early 1990s, we discovered that the statute was not adequate to protect privacy and encourage accuracy, and enacted the FCRA Amendments in 1996. Today, the evidence is compelling that the current law is still inadequate and must be strengthened, and that the States have played and will continue to play an important role in protecting consumers and improving the system.

CRA Methods Can Cause Inaccuracy

A fundamental problem with inaccuracy is that it can cause the unjust denial of credit.

In several of the cases in which I have served as an expert witness, CRAs have mis-merged data about two different consumers because their algorithms tolerate what's known as "partial matches." If you are an unlucky consumer who gets on the wrong side of a CRA's algorithms, your life can become a nightmare.

First, a brief description of how the database systems of the three major CRAs operate. The credit grantors (furnishers) regularly send the CRAs millions of bits of data on consumers' payment histories. The CRAs store this information in a massive database that includes information on virtually all American adult users of credit. When a consumer applies for credit, the credit grantor (subscriber) relays to the CRA identifying data from the consumer's credit application, at a minimum, name and address, often the SSN, and sometimes date of birth. Applying this identifying or "indicative" data, the CRA's algorithm then decides which information in the database relates to or "matches" that consumer, and then "returns" to the credit grantor (subscriber) a consumer credit report consisting of these data.

The algorithm has a list of factors it considers when deciding which data in the database apply to which consumers. The first factor is geographic region. Another key factor is the SSN. First name and last name are separate factors.

From the CRA's point of view, an important goal is to provide the credit grantor with all data it has about the consumer and to ensure that nothing is missed. Therefore, TU seeks to maximize disclosure of any *possible* information that might relate to consumer about whom a subscriber inquires. To accomplish this, the algorithm is designed to accommodate such errors as transposed digits within SSNs, misspellings, nick names and changed last names (women who marry), by accepting "partial matches" of SSNs and first names, and in some circumstances, assigning less importance to last names.

In my opinion, the manner in which CRA's systems tolerate partial matches has been a primary cause of mixed files and other inaccuracies, and has been readily exploited by identity thieves.

For example, the testimony in the case of Judy Thomas, a resident of Klamath Falls, Oregon, was that Thomas' SSN was only one digit different than that of Judith Upton, of Stevens, Washington. This, probably coupled with partial matches on first name, caused CRA's algorithm to assume that the one-digit difference was a clerical error and that Thomas and Upton were the same person, with one SSN. Many of Upton's derogatory trade lines were improperly merged on to Thomas' credit report, causing delays in obtaining a mortgage and other hassles and distress.

In the case of Myra Coleman, of Mississippi, Maria Gaytan, of California, applied for credit using Ms. Coleman's SSN, creating an exact match of the SSN. This exact match allowed

CRA's algorithm to tolerate major and obvious differences in last name, address, City, State and date-of-birth. Gaytan's derogatory trade lines then polluted Coleman's credit report.

Then there is the case of Carol Fleischer, who was improperly merged with Carolyn Cassidy. In 1991, when she applied for credit, the CRA's algorithm saw there was another "Carolyn" (albeit Cassidy) living in Michigan (albeit Highland, instead of Ann Arbor) and an SSN with only one digit difference. This caused Cassidy's negative trade lines to be merged into Ms. Fleischer's credit report, which was then returned to the credit grantor to which Ms. Fleischer had applied for credit. But in 1997, Ms. Cassidy apparently put Ms. Fleischer's SSN on Cassidy's credit applications. Again, the exact SSN match, coupled with a partial match in the first name and market area, allowed the CRA algorithm to tolerate obvious differences in several other data fields. In sum, instead of using the SSN as a tool for inaccuracy, in these situations, the CRA converts the SSN into a tool for inaccuracy.

In certain circumstances, some CRA algorithms tolerate a partial SSN match of 7 out of 9 digits. In my opinion, this is inconsistent with separate consent agreements between the CRAs and either the State Attorneys General or FTC to use "Full Identifying Information," defined as "full last and first name; middle initial; full street address; zip code; year of birth any generational designation; and social security number."

<u>Inadequate Reinvestigation, Major Volume</u>

It can be very problematic for consumers when a CRA improperly mixes their data with someone else. But it can be extremely maddening when the CRA then fails to "unmix" it after errors are disputed.

Every independent study of the credit reporting system has found significant levels of inaccuracy. This includes the most recent studies from the Consumer Federation of America and the Federal Reserve Board, and a succession of studies by the U.S. Public Interest Research Group and Consumers Union ranging back to 1990.

In my opinion, another indication of inaccuracy is the large volume of disputes received by the CRAs. The estimates are that CRAs receive from anywhere between 5,000 to 25,000 consumer disputes per day, with 7,000-10,000 being the more typical range. CRA dispute handlers are expected to handle between 10-12 consumer disputes per hour. Because each consumer dispute averages three disputed items, this means the CRA employee only has a few minutes to handle each disputed item (36 disputed items, divided by 60 minutes = 1.66 minutes)

(What we do not know at this point is what percentage of disputes are driven by credit repair clinics, which typically attempt to flood the system.)

Credit grantors have seen a jump in dispute volume as well. For instance, in October 2001, Capital One received about 1,000 disputes per day, according to a company official. By May 2002, it had grown to 2,000 disputes per day. The official said the number of disputes has now grown to 4,000 per day.

To deal with this volume, the CRAs and furnishers have set up an automated system for exchanging messages when consumers dispute inaccuracies in their credit reports. For example, a consumer writes to the CRA to dispute inaccurate information in his or her credit report. The consumer's letter provides detail of the errors. Supporting documentation is attached. But rather than forward this information to the furnisher, the CRA typically reduces the consumer's dispute to a two-digit code (usually meaning "Not Mine") and sends it to the furnisher. The furnisher typically will only check to see if the information it previously furnished is the same information it has on file. If it is the same, then the furnisher "verifies" the previously furnished information.

In other words, market forces, i.e., the high volume of disputes and the cost of human resources, have prompted the financial services industry to cut corners when it comes to FCRA reinvestigations.

This process is particularly maddening for consumers who are victims of mixed files and/or identity theft. For instance, when Judy Thomas disputed information generated by Judith Upton, the furnishers "verified" the information because they previously had reported the same information about Judith Upton.

Of course, this is a huge breakdown in how the system is supposed to work. In the 1996 Amendments, Congress specifically required CRAs to "forward all relevant information" concerning a consumer dispute to the furnishers. All parties were required to conduct reinvestigations. This two-dimensional message exchange does not amount to a true reinvestigation. (My *Webster's New Collegiate Dictionary* defines "investigate" as "to observe or study by close examination and systematic inquiry." One of the definitions of "systematic" is "marked by thoroughness and regularity.")

The testimony before this Subcommittee last week by Leonard Bennett, a Virginia consumer attorney, provides great detail as to the defects in this process. The bottom line is that the current "reinvestigation" process engaged in by CRAs and credit grantors is not designed to find the truth. Like Mr. Bennett, I quote from a deposition of the Capital One employee responsible for consumer disputes, who was being questioned by Michigan attorney Ian Lyngklip.

> Q For purposes of how you administer to the FCRA, does the underlying truth of the matter enter into the decision? In other words, if the information in Cap One's system is not, in fact, true, is Cap One going to verify the data as accurate as long as it matches?
> A Not -- if we -- if we do not -- I'm not quite sure if you're -- are you -- restate that question.
> Q Sure, I can do that. Cap One, as a matter of how it administers to the FCRA --

A Uh-huh.

Q -- and looks at the accuracy requirements, does not equate accuracy with truthfulness, what it does is it measures accuracy in terms of whether or not the data matches between what's in the credit reporting system and what's in Cap One's computer; is that a fair statement? . . .

A So your, your -- the way the question is posed to me makes it sound like I have to choose between whether I'm saying what my associates do is accurate or truthful but not both.

Q Well, no, what I'm asking is this: Is it possible, is it possible that Cap One will verify information that is not, in fact, truthful?

A There's a possibility of that. It certainly would not be done intentionally.

Unfortunately, I have seen several cases in which furnishers "verified" derogatory data about consumers that simply was not true. So far, several of the major credit grantors use a similar, two-dimensional system, and the CRAs appear to encourage them to do so. In the near future, I intend to write a letter to the CRAs advising them that the reinvestigation procedures of several major furnishers do no attend to a sufficiently high standard of care and are not designed to effectuate a true reinvestigation. Similarly, I intend to advise the furnishers that the CRA's, as a matter of course, often fail to forward to them all relevant information provided by the consumer, again, undermining the reinvestigation process.

Other problematic procedures by either the CRAs, furnishers and users include:

- Raising interest rates on consumers who were never late, but based on review of their credit reports
- Continuing account reviews well after a consumer has terminated a relationship with a creditor
- Using the national credit reporting system as an arm of debt collection in an unfair manner
- Lack of consistency in issuance of adverse action notices

The Damaging Nature Of Inaccuracy, Non-Responsiveness, Faulty Reinvestigations & Identity Theft

I will try to briefly summarize some of the ways in which consumers are damaged by inaccurate credit reports, non-responsiveness and faulty reinvestigations by CRAs and furnishers.

- Inaccurate data can lead to the unjust denial of credit or insurance
- In the age, of risk-based pricing, inaccuracies can result in the granting of credit or insurance on less favorable terms.
- Seeking to facilitate correction of inaccuracies can be time-consuming, causing a lost of time, energy and opportunity.
- Often the most profound damage that consumers suffer is the emotional distress that accompanies: the discovery of inaccuracies in one's credit report; and/or the frustrating process of trying to correct errors that were to not of one's own making; and/or the unjust denial of credit; and/or of being told that false information about you has been "verified," and/or that information that was previously deleted as inaccurate was reinserted without notice.

It also is distressful not knowing everyone who may have associated you with highly derogatory credit data. It can be difficult to maintain constructive personal relationships under stress. It can be difficult to perform adequately at one's job.

With identity theft, all of the above damages apply, compounded by the fact that a criminal is joyriding on your good credit, ruining your name.

In fact, some of the worst damages resulting from identity theft relate to the consumer's frustrating interaction with the national credit reporting system. As Jodie Bernstein, former head of the FTC's Bureau of Consumer Protection testified July 12, 2000 before the Senate Judiciary Subcommittee on Technology, Terrorism and Government Information,

> "The leading complaints by identity theft victims against the consumer reporting agencies are that they provide inadequate assistance over the phone, or that they will not reinvestigate or correct an inaccurate entry in the consumer's credit report. In one fairly typical case, a consumer reported that two years after initially notifying the consumer reporting agencies of the identity theft, following up with them numerous times by phone, and sending several copies of documents that they requested, the suspect's address and other inaccurate information continues to appear on her credit report. In another case, although the consumer has sent documents requested by the consumer reporting agency three separate times, the consumer reporting agency involved still claims that it has not received the information." http://www.ftc.gov/os/2000/07/idtheft.htm

In her March 7, 2000 testimony before the Subcommittee, Bernstein elaborated further:

> A consumer's credit history is frequently scarred, and he or she typically must spend numerous hours sometimes over the course of months or even years contesting bills and straightening out credit reporting errors. In the interim, the consumer victim may be denied loans, mortgages, a driver's license, and employment; a bad credit report may even prevent him or her from something as simple as opening up a new bank account at a time when other accounts are tainted and a new account is essential. Moreover, even after the initial fraudulent bills are resolved, new fraudulent charges may continue to appear, requiring ongoing vigilance and effort by the victimized consumer." . . .
>
> Identity theft victims continue to face numerous obstacles to resolving the credit problems that frequently result from identity theft. For example, many consumers must contact and re-contact creditors, credit bureaus, and debt collectors, often with frustrating results."
> http://www.ftc.gov/os/2000/03/identitytheft.htm

The General Accounting Office wrote in one of if its first reports on identity theft in 1998:

> "Identity theft can cause substantial harm to the lives of individual citizens -- potentially severe emotional or other non-monetary harm, as well as economic harm. Even though financial institutions may not hold victims liable for fraudulent debts, victims nonetheless often feel 'personally violated' and have reported spending significant amounts of time trying to resolve the problems caused by identity theft -- problems such as bounced checks, loan denials, credit card application rejections, and debt collection harassment," it wrote. (GAO-02-424T, *Identity Theft: Available Data Indicate Growth in Prevalence & Cost* (www.gao.gov/new.items/d0242t.pdf)

What's at stake here is nothing less than the good name of every American who participates in the economy. The view that one's good name is of paramount importance is supported by FTC complaint statistics. In 1993, the U.S. Public Interest Research Group (USPIRG) issued a report based upon a Freedom of Information Act request to the FTC, which showed that inaccuracies in credit reports was the leading cause of consumer complaints to the FTC. This category led all others, including categories that include out-of-pocket losses.

1. Credit bureaus (30,901);
2. Misc. Credit (22, 729);
3. Investment Fraud (12,809);
4. Equal Credit Oppt. (11,634);
5. Automobiles (6,901);
6. Truth-In-Lending (6,303);
7. Household Supplies (5,835);

8. Recreational Goods (5,747);
9. Mail Order (4,687)
10. Food/Beverage (2,738).

Ten years later, FTC complaint statistics confirm that consumers care most about protecting their good name, well above other categories involving out of pocket losses. For three years running, identity theft is the leading cause of complaints to the FTC, These are the numbers from the FTC's January 23, 2002 release

1. Identity Theft (42%);
2. Internet Auctions (10%)
3. Internet Services and Computer Complaints (7%)
4. Shop-at-Home and Catalog Offers (6%)
5. Advance Fee Loans and Credit Protection (5%)
6. Prizes/Sweepstakes/Gifts (4%)
7. Business Opportunities and Work at Home Plans (4%)
8. Foreign Money Offers (4%)
9. Magazines and Buyers Clubs (3%)
10. Telephone Pay-Per-Call/Information Services (2%)

http://www.ftc.gov/opa/2002/01/idtheft.htm

This might be surprising to some, but it shouldn't be. Protecting one's good name is so fundamental to mankind that Shakespeare wrote about it some 400 years ago.

> Who Steals My Purse steals trash: 'Tis something, nothing;
> Twas mine 'tis his and has been slave to thousands.
> But he that filches from me my good name
> Robs me of that which not enriches him,
> And makes me poor indeed.

Because credit-reporting problem can be extremely damaging to consumers, I urge this subcommittee to devote one hearing to taking testimony from victims of credit report inaccuracy and identity theft. In my opinion, only that way will the subcommittee get a full appreciation of how profoundly damaging these problems are, and why stronger measures are needed to prevent them.

The Exemption Provisions

There has been a lot of discussion about the need to reauthorize the FCRA preemption provisions in order to maintain uniform national standards. But in at least in three crucial areas, the preemption provisions either do not set any real national standard or set ones that are so weak and ineffective that they need to be significantly strengthened. Moreover, consumer protection would be advanced by freeing up the States to protect their citizens in this area, particularly if Congress is unable to enact a sufficiently strong national standard.

Duties On Furnishers

As a political compromise, Congress in 1996 created a multi-tier system that places only a minimal duty on furnishers to report information accurately to credit bureaus. The first national standard (1681s-2(A)) merely requires that creditors not furnish information that they know or consciously avoid knowing is inaccurate. This standard is extremely weak; the American people deserve better. If there is non-compliance with this provision, even after the consumer notifies the credit grantor of the reporting errors, then the only entities that can take enforcement actions are the federal or state agencies with jurisdiction. To my knowledge, there have been no enforcement actions under this section.

Individuals only have the right to enforce their own rights under the second national standard (1681s-2(B)) after: (1) they dispute the credit grantors' errors with the CRA, (2) the CRA communicates that dispute to the credit grantor, and, (3) the credit grantor reports the disputed inaccurate information again.

In my opinion, these FCRA "national standards" contribute to inaccuracy because they give credit grantors much too much leeway to engage in sloppy reporting practices. In practice, they have proven to be ineffective. They create too many hoops for consumer to jump through in order to facilitate simple correction of errors. For instance, if the consumer is not aware that he must dispute a credit grantor error with the CRA, then he cannot get enforcement unless some Federal agency like the OCC is willing to go to bat for him. (You can bet that won't happen.) If he does report it to the CRA and the problem continues, some consumers have found it difficult to prove that the CRA relayed the dispute to the credit grantor. Even when consumers have satisfied these requirements, leading credit grantors, like Sears and MBNA, have argued that S-2(b) doesn't give consumers the right to sue. As Leonard Bennett told you last week, MBNA argues that there is no national standard. I disagree with MBNA on this point, but it is clear that the standard is not sufficient to protect consumers' privacy and promote healthy accuracy throughout the national credit reporting system. Therefore, if the Committee is unable to bolster protections for consumers in this area, it should leave the States free to do so.

Pre-Screening

Another national standard, relating to pre-screening, requires senders of so-called pre-approved credit or insurance offers to "provide with each written solicitation . . . a clear and conspicuous statement that" the CRA was the source of the information and that the consumer can opt out. As confirmed by the piles of pre-approved credit offers that most of us receive via the mail, most of the notices in reality are neither clear nor conspicuous. In his testimony last week, U.S. PIRG's Ed Mierzwinski included a typical opt-out notice in his testimony. Most of the notices feature the kind of fine print that consumers typically ignore, mimic the language from the statute itself, and would not score high in readability tests. They usually include sub-heads that would not attract the reader's eye, like, "Notice Regarding Pre-Screened Offer," or Terms of Pre-Approved Offer," or Fair Credit Reporting Act Notice."

In other words, these are "notices" that are designed not to be noticed. The first line typically advises that "information in your credit report was used in connection with this offer," and "you received this offer because you satisfied the criteria for creditworthiness used to select you for this offer." The next line finally informs you that you're not really pre-approved in the way you might think: "Grant of this offer, after you respond to it, is conditioned upon your satisfying the creditworthiness criteria used to select you for the offer." By the fourth line, the notices advise, "You have the right to prohibit use of information in your file with any credit reporting agency in connection with any transaction that you do not initiate." If the reader gets through all that, he can finally find the address to write the three CRAs or the number to call (888) 567-8688.

In my opinion, the vast majority of Americans, despite regularly receiving pre-screened offers, are not aware that these offers are generated from their credit report. We may learn soon that there is a heightened urgency in making Americans aware.

Privacy Times is in the early stages of an investigative story on how various criminal gangs across the nation, intent on committing identity theft and credit fraud, are targeting mail boxes for consumers' personal information and financial instruments. Their favorite targets include "convenience checks," pre-approved credit card offers and bank statements. The gangs involved with these have demonstrated different levels of sophistication. Some consist of drug addicts; others are associated with specific foreign nationals. Some of the more active gangs hit 200-300 mailboxes in one day. Some of the gangs try and use convenience checks or pre-approved credit card offers to get credit quickly. Others sell the personal data to other gangs specializing in identity theft, credit fraud and counterfeiting.

In one recent month in one mid-sized western city, there were 20 arrests and 14 prosecutions. In that city, one law enforcement team has four of its six investigators dedicated to identity theft.

Like everything related to identity theft, the raiding of mailboxes by ID theft gangs promises to get worse. Therefore it is imperative that we strengthen the rights of Americans to have reasonable control over their identifying information and sensitive financial data so they can protect themselves against identity thieves. This means not only strengthening consumers' rights to know about and stop the use of their data for pre-screening, but also blocking use of their personal data for other financial offers that might not be made from affiliate-sharing or other process that falls outside of the FCRA-regulated pre-screening. I agree with U.S. PIRG that the solution to this problem is a national "Do Not Send Credit Offers" Registry, similar to the "Do-Not-Call" Registry being developed by the FTC.

Pre-screening clearly played an important role in the past decade's credit boom. But we have to recognize that times are changing, so we are looking forward and "not fighting the last war." The above-described threat from criminal gangs should cause us to examine critically the costs and benefits of pre-screening. Moreover, in today's hyper-competitive credit markets, consumers have an array of choices and ways they can find the best credit offers when they so choose, including radio and print ads, the Internet and the telephone.

<u>Affiliate Sharing</u>

"No requirement or prohibition may be imposed under the laws of any State . . . (2) with respect to the exchange of information among persons affiliated by common ownership or common corporate control." Thus, the FCRA's provision on affiliate-sharing do not set a national standard, it simply bars State action. In effect, the provision says there shall be <u>no standard</u>.

Because the provision was added hastily in 1996 with no hearings or analysis, it is poorly crafted and confusing. The financial services industry has argued that the provision bars California or its localities from enacting provisions that would strengthen consumers' rights to opt-out from affiliate sharing of financial data not covered by the FCRA.

This is a rather bizarre situation, because Gramm-Leach-Bliley also does not set a national standard on affiliate sharing – it only provides notice and opt-out for sharing with third parties. In GLB, Congress recognized that affiliate sharing implicated important privacy issues and specifically added the Sarbanes Amendment, preserving the rights of the States to enact stronger financial privacy laws, including ones that gave consumers rights in relation to affiliate sharing.

The GLB notice-and-opt out standard has proven ineffective. The notices generated under the law are confusing to consumers and costly to industry. Last year, the people of North Dakota voted 72% in favor of restoring an opt-in financial privacy law. If the California legislature fails to pass Sen. Jackie Speier's legislation (SB 1, an opt-in for third parties, opt- out for most affiliates), then Californians will vote an even stronger initiative in March 2004. Opinion polls show that 85-90% of Californians favor an opt-in standard for their sensitive financial data.

This should come as no surprise. I would urge members of this committee, when opportunity arises, to ask constituents two straightforward questions: "Should banks have to get your permission before they sell or share your financial data with outsiders? Should you have any rights to stop companies from sharing your financial data among affiliates?"

Congress has the opportunity to correct the mistakes of GLB, which is not based upon traditional Fair Information Practices standards, and expand the protections of the FCRA to all sensitive financial data. The American people want this. If Congress is unable to accomplish this, the States must be left free to protect their citizens.

In my opinion, problems in the current system are too far-reaching for Congress to come with thoughtful, workable legislative solutions in less than six months. After all, it took <u>six years</u> to enact the 1996 amendments. To advance the legislative debate, I've attached the following list of preliminary concepts for improving the law.

Preliminary Concepts For Improving The FCRA/National Financial Privacy Law

The following are some of the preliminary concepts are vital to updating the FCRA and national financial privacy laws. This list is the work of several groups and experts, including U.S. PIRG, Consumers Union, Consumer Federation of America, National Association of Consumer Advocates, National Consumer Law Center and myself.

BRIEF SUMMARY OF IMPROVEMENTS FOR FCRA, FINANCIAL PRIVACY

1) Strengthen, Promote Consumer Access To Credit Reports
   A. One Free report per year w/ Credit Score (Explained)
   B. Cap price of monitoring/alert services
      (Accuracy & ID Theft Benefits)
   C. Require credit grantor to provide credit report that caused adverse action

2) Improve Accuracy
   A. Strengthen Duty On Furnishers To Report Accurately & Reinvestigate Disputes –
   B. Require that furnishers who report, abide by a "completeness" standard
   C. Notify consumers when negative info reported
   D. Shorten reinvestigation period

3) Identity Theft
   A. Match four identifiers before disclosing credit report
   B. Fraud Flag Alert
   C. Address Change verification
   D. Get the SSN out of circulation (Anti-Coercion, Credit Headers)

4) Strengthen Consumer Rights Over Pre-Screening
   A. Notice prescribe by statute, prominence requirement
   B. Have a National Opt Out Registry for All Credit Card Offers

5) Affiliate-Sharing Privacy –
   A. Enact Shelby-Markey opt-in, opt-out for third party & affiliate-sharing
   B. Extend access/correction rights to all financial data

6) 'Democratize/Popularize' Enforcement
   A. Minimum statutory damages
   B. 'Catalyst theory' for attorneys fees
   C. Express consumer right to File In Small Claims Court (Like TCPA)

7) Add Injunctive Relief

8) Ban Use of Credit Scores in Insurance

9) Eliminate State Preemption

Testimony of

Mr. Scott Hildebrand
Vice President, Direct Marketing Services
Capital One Financial Corporation

before the
House of Representatives Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

"The Role of FCRA in the Credit Granting Process"

June 12, 2003

Chairman Bachus, Ranking Member Sanders and Members of the Subcommittee. My name is Scott Hildebrand and I am appearing before you on behalf of Capital One Financial Corporation where I serve in the capacity as Vice President for Direct Marketing Services. On behalf of Capital One, let me express my thanks to you and Chairman Oxley for the leadership you have shown on this important issue. We greatly appreciate this opportunity to discuss the "Role of the Fair Credit Reporting Act (FCRA) in the Credit Granting Process." We believe that the permanent extension of the national standards contained in the FCRA is essential to the continued health of our nation's economy. Since its enactment, the FCRA has delivered extraordinary benefits to consumers, helping to fuel innovation and competition in the financial services industry that has made credit less costly and more widely available that at any time in U.S. history.

Capital One is one of the top 10 largest credit card issuers in the nation, and a diversified financial services company with over 48 million customer accounts and $68 billion in managed loans outstanding. In addition to credit cards, we are one of the nation's premier auto finance companies, and also offer our customers an array of banking and related products. We employ nearly 18,000 associates worldwide, with offices around the country and overseas.

I. An Overview of the Role of the FCRA in Creating a National Credit Granting Process

The FCRA Created a National Competitive Environment for Credit Grantors

In many ways, Capital One is a creation of the competitive environment established by the uniformity provisions of the FCRA. The primary role of the FCRA is to benefit consumers by providing a national framework of rules governing the use of credit information that does not favor any particular type of lender or corporate structure in any particular geographic location. In other words, to create a vibrant nationwide marketplace free of the old paradigm of dominant local or regional institutions which tended to stifle competition and with it, consumer choice.

That competition is alive and well today. In 2001, approximately 6800 financial institutions issued general purpose credit cards such as MasterCard and Visa, in addition to those issued by American Express, Discover and many retailers.[1] A 2002 Federal Reserve survey indicates that of the 176 largest credit card issuers, 64 distribute their cards nationally, Capital One among them.[2] Obviously, this market is not dominated by any one issuer. There are few barriers to entry and exit. Over the past year, the top 10 issuers lost market share to newcomers such as Juniper Bank and the banking arm of State Farm Insurance.[3]

---

[1] *The Profitability of Credit Card Operations of Depository Institutions: An Annual Report by the Board of Governors of the Federal Reserve System,* June 2001.
[2] *Ibid.*
[3] *Credit Cards, 2003,* SMR Research.

Competition remains intense, and everyday at Capital One, our associates work hard to retain our existing customers, acquire customers new to the market and, not surprisingly, to attract the customers of our competitors with better offerings. This competitive environment commenced 30 years ago with the passage of the FCRA and accelerated greatly with the amendments to the Act in 1996. It is no exaggeration to say that we would not have seen this level of competition in the balkanized, localized credit card markets of 30 years ago – markets that featured high, largely undifferentiated pricing combined with an onerous and highly subjective application process. Worse still, availability and access were greatly limited. By and large, you did not lend money to individuals that you did not "know" in a particular community, and virtually all consumer lending occurred through a "bricks and mortar" delivery system which favored location over product choice.

Beginnings of the Modern National Underwriting System

With developments in information technology, the credit granting process began to change. The FCRA was originally passed in 1974 to acknowledge the beginnings of a national consumer credit market. Credit became more widely available on a national basis, as credit bureaus developed large databases that provided lenders with a more holistic and consistent view of a particular consumer's risk characteristics. Pricing was still not highly differentiated, but access had improved significantly over the old balkanized model. Nevertheless, approximately half of the eligible U.S. population could still not qualify for a credit card.

Even as late as 1987, the credit card market was mired in a "one size fits all" approach, characterized by uniform interest rates and annual fees.

Largest Ten Issuers (1987)	APR	AMF
Citibank	19.8%	$20
Bank America	19.8%	$20
Chase Manhattan	19.8%	$20
First Chicago	19.8%	$20
Wells Fargo	19.8%	$20
First Interstate	19.8%	$20
Manufacturers Hanover	19.8%	$20
MNC Financial	19.8%	$20
Marine Midland	19.8%	$20
Security Pacific	19.8%	$20

The market was ripe for innovation, and companies like Capital One saw an opportunity to utilize the information provided by our national credit reporting system to customize product offerings to customers based on their particular needs, interests and risk profiles. Not coincidentally, the rise of Capital One, and of information based underwriting and marketing in the lending arena, really begins at the time of the 1996 amendments to the FCRA.

Our founders realized that the "one size fits all" approach made little sense in an environment where each consumer possessed vastly different needs and characteristics. While some consumers were risky, many more were not. Without the ability to differentiate one from another, however, lenders were compelled to raise prices to cover the cost of higher credit losses, or to cut back on the granting of credit to reduce the losses themselves. Either way, consumers suffered. The less risky customers were simply paying too much, and for the rest, credit was hard to come by – if available at all.

Capital One was able to utilize information within the legal framework provided by the FCRA to make significant advances in underwriting – better distinguishing the risk characteristics of our customer base. The benefits of greater access to better information went far beyond risk analysis, however. Capital One and other companies were also able to utilize information to create profound innovations in the marketing and design of credit cards. Our company led the charge with new product ideas like balance transfers, where customers could shift balances away from high priced cards to our lower priced offerings, and low introductory rates. The resulting reductions in price and penetration into traditionally underserved markets sparked a consumer revolution known as the "democratization of credit."

By 2003, the moribund competition and flat pricing structure of old was no more. In its place came fierce price competition which has produced billions of dollars in savings for consumers across the country.

Largest Ten Issuers (March 2003)	**Lowest Long-Term APR**	**AMF**
Capital One	6.90 % Fixed	$0
Chase	7.24% Variable	$0
Bank of America	7.90% Fixed	$0
MBNA	7.90% Fixed	$0
Bank One	8.90% Fixed	$0
Fleet	8.99% Variable	$0
Providian	8.99% Fixed	$0
American Express	9.24% Variable	$0
Discover	9.99% Variable	$0
Citibank	10.24% Variable	$0

Notably, these numbers actually fail to capture the true savings to consumers of increased competition, as they do not take into consideration the widespread availability of low introductory and balance transfer rates.

The last decade also saw significant developments in the pioneering of affinity cards, with benefits for consumers and the organizations they most value; rewards programs which provide consumers with value added benefits ranging from airline miles to college savings plans; and co-branded products, which allow consumer to enjoy discounts and other privileges at their favorite retail outlets.

Capital One has been able to take this market leading approach in reinventing other lending businesses, including auto finance. Through our affiliates, Capital One Auto Finance and PeopleFirst, we have pioneered innovations such as a unique auto refinance product that allows consumers to take advantage of lower rates, like they do when mortgage rates decline. Our on-line loan approval process qualifies individuals for full pre-financing of their auto loans in minutes, at industry leading rates, eliminating the lengthy, unpleasant and often costly trip to the dealer's finance desk.

The power of this heightened competition has not been lost on consumers – in just eight years as an independent company, Capital One has grown its account base from 5 million to 48 million worldwide – all without the once vital "bricks and mortar" network of branches. We can give consumers the best deals no matter where they reside – from mid-town Manhattan to the smallest farm community in Iowa.

For consumers, the tremendous benefits spurred by the FCRA are self-evident: prices continue to decline and availability to widen – most notably in the traditionally underserved low and moderate income communities.

With this broad overview of the role of the FCRA in the credit granting process, we can now examine the crucial role that key individual provisions of the Act play in ensuring that consumers enjoy the product offerings they deserve.

II. The Role of Specific Provisions of the Fair Credit Reporting Act in the National Credit Granting Process

The interdependent provisions of the FCRA can be arranged generally into three groups: (1) credit data consistency; (2) permitted uses of credit data; and (3) consumer rights.

The FCRA and National Credit Data Consistency

The provisions of the FCRA that ensure national credit data consistency include those related to furnisher responsibility and determinations of what is excluded from and included in consumer reports. The furnisher responsibility provisions strike a sensible balance by providing incentives to voluntarily report information accurately while removing disincentives to such reporting by keeping costs and liability within rational limits. The balance achieved enables companies like Capital One to construct highly accurate credit models on a nationwide basis – one of the key building blocks of a national credit underwriting process. These provisions benefit consumers by increasing the availability and reducing the price of credit, while also improving the convenience and speed of approval.

Voluntary nature of the consumer reporting system

It is worth spending a moment on the voluntary nature of the credit data reporting system. The question has been asked: why don't we just make reporting mandatory for everyone? At first glance, this approach appears logical; but in reality, you risk choking the system with inconsistent, low quality data that has little predictive value. To illustrate, why compel a small business such as "Bob's Muffler Shop" – which may offer customers a "90 Days Same as Cash" option – to take on the significant burdens and costs of reporting into a system that they do not, in fact, use and, therefore, is irrelevant to their business? Would such a business be properly incented to take the time to report as accurately as those who depend on the system would likely choose to do?

The system works primarily because consumer reporting agencies, and the institutions that provide credit data information, share incentives to ensure that those who use the system also report into the system, and that the data reported is as consistent and accurate as reasonably possible. Our point is not to prevent Bob's Muffler Shop from reporting information into the system if that business sees value in doing so, but there is nothing to be gained by forcing them to do so.

Based on the voluntary nature of the system, it is an absurd argument that those who use the data as part of their credit granting process do not have a significant stake in the accuracy of the information provided on consumers. Put most simply, at Capital One, our models do not work if the information contained in the bureau reports is not accurate.

Permissible Uses of Credit Data

This group of provisions includes the processes of prescreening and affiliate sharing. Taken together, these provisions enable companies like Capital One to use information to reach potential customers and to make prudent credit decisions that ensure the safety and soundness of the lending institution. In terms of consumer benefits, these provisions, particularly the prescreening process, increase credit availability, reduce prices and speed access. Most significantly, they provide customers with preapproved offers of credit – virtually removing the fear of rejection that historically characterized the traditional customer-initiated credit application process.

Some have argued that prescreening and affiliate sharing constitute "marketing" rather than "underwriting" and, therefore, represent less important components of our uniform national system. As the discussion below illustrates, this distinction is inappropriate, and misunderstands the vital interdependencies of the current system as enabled by the FCRA. Stated more plainly, our current system cannot operate effectively without all of its constituent parts.

The Role of Prescreening and Affiliate Sharing in the National Credit Granting Process

Prescreening and affiliate sharing enhance the reliability of credit underwriting decisions; help reduce the cost of credit to millions of consumers; and expand the availability of credit, particularly to traditionally underserved populations in urban and rural America. Moreover, affiliate sharing and prescreening are almost certainly the single most important catalysts of the intense competition in today's consumer credit marketplace, particularly in credit cards, but also increasingly in auto finance and other lending arenas.

Prescreening greatly enhances the ability of credit grantors to accurately assess risk and avoid losses

Our experience confirms that losses from customers obtained through prescreened offers of credit are significantly lower than losses from customers obtained through non-prescreened channels (e.g., "invitation to apply" direct mail; in-store "take-one" applications; internet banner advertisements). The reason, at first blush, may appear counter-intuitive – not all customers are good customers. Unlike other retail businesses where money is paid at the time of purchase, lending involves the provision of money in exchange for the promise to pay. Prescreening permits us to obtain the necessary information to properly assess risk, and to mail an offer that best suits the needs and circumstances of particular customers. In doing so, we can make prudent determinations regarding the probability of repayment and the appropriate credit line or loan amount to be offered. Prescreening, therefore, is a vital tool in ensuring the continued safety and soundness of consumer lending institutions.

Prescreening lowers costs both to providers and recipients of credit

Because prescreening is a highly cost-efficient and proven way to identify lower risk customers, both consumers and credit grantors enjoy enormous benefits from this system. Consumers benefit in the form of significantly lower costs for credit; and credit issuers benefit through large reductions in underwriting costs. In testimony before this committee last week, economist Robert Turner of the Information Policy Institute stated that with respect to consumer benefits, his recent study concludes that, since 1997, consumer savings in the cost of credit from the increased competition in the credit card industry – largely enabled by prescreening – <u>is about $30 billion per year</u>.[4]

Prescreening fosters competition

Prescreening is almost certainly the single most important dynamic driving competition for consumer credit. Because prescreening allows financial services firms to identify the credit characteristics of individuals with whom customer relationships are sought, credit issuers are able to offer their credit products with tailored terms and conditions specifically designed to "beat the competition." The attractiveness of our offers depends on what we know – if your current card carries a 9.9 percent interest rate, it makes little sense for us to send you an offer for a 10.9 percent product.

As noted above, prescreening also foster innovation. The extraordinary ancillary benefits attached to modern credit card products are largely a function of prescreening. Airline miles, cash rebates, contributions to college savings plans, store discounts, merchandise – all of these reward programs have become commonplace to the point of being expected, if not demanded, by consumers. Lest we forget, however, few if any such programs existed just two decades ago – unless you count the ubiquitous free toaster provided by your local bank.

Such programs are naturally dependent on information about consumer preferences, but also depend largely on improved risk analysis to keep losses – and costs – down. The

[4] Testimony of Michael Turner, The Information Policy Institute before the Subcommittee on Financial Institutions, Committee on Financial Services, U.S. House of Representatives, May 8, 2003.

importance of lower costs in this context is significant – benefits such as airline miles cost us money. These programs can only remain viable if high credit losses do not undercut their profitability.

The success of prescreening in the credit card arena has also fostered innovation in the auto finance market. Our highly successful auto refinance products, which can save consumers up to 4 percentage points on their loans, is made possible through prescreening. Bureau data allows us to determine which consumers would benefit from a reduction in their APR, and helps to ensure that our offering will, in fact, save them money.

Prescreening makes credit available to traditionally underserved populations.

Prescreening enables credit issuers to find good credit risks among traditionally underserved populations and to extend credit to them in ways that would be difficult or impossible through other credit application channels.

Prescreening reduces identity theft

Because the process of prescreening involves additional confirmation of a consumer's identity, prescreening actually works to reduce identity theft and other forms of fraud in connection with the opening of new or additional accounts. Our data demonstrates that rates of identity theft and other fraud is 5 to 15 times lower for credit generated through prescreening than from credit generated through other channels (e.g., the internet, in-store "take-ones"). Our experience is supported further by testimony from the Information Policy Institute, which concluded that prescreened credit card solicitations are significantly less likely to result in fraud than other forms of account acquisition (prescreening customer-verification procedures identify between 60% and 80% of all fraudulent applications before accounts are opened – a considerably higher rate of prevention than with other application channels). Additional fraud prevention techniques are applied when prescreened applications are accepted.[5]

Affiliate sharing of information enhances the ability of credit grantors to accurately assess risk and extend credit to traditionally underserved populations

The quality, quantity and timeliness of customer credit information available through affiliate sharing greatly increases the likelihood that a lending institution will make a prudent credit decision. Testifying before this subcommittee, the National Retail Federation put it well: "A lot of people ask what affiliate sharing has to do with the granting of credit. The answer is: a lot." Capital One uses the data and transaction histories of the customers of its two banking institutions and its auto finance company to ensure the creation of the most accurate file possible. Most importantly, this information supplements the broader information obtained through the credit reporting system to create more reliable internal credit scores and models that help determine a consumer's eligibility for credit.

---

[5] *Ibid.*

Because affiliate sharing permits providers of consumer credit to reduce their overall risk of loss, the cost of credit to their customers is also reduced

Like prescreening, affiliate sharing greatly enhances the safety and soundness of our lending institutions by improving our predicative capabilities and reducing losses. The savings generated by our ability to reduce losses are passed on to our customers. If the ability of lending institutions to share information among affiliates is eliminated or reduced, the cost of credit to their customers will increase.

Affiliate sharing allows financial services companies to provide to offer their customer of wider array of products and services to their customers on a customized basis

In the absence of affiliate-sharing, financial services companies would know decidedly less about their customers financial and other needs than they currently do, making it far more difficult to address those needs on an individualized basis. Capital One has created significant value for its card customers by offering reduced rates on auto loans through its affiliated auto finance company. These reduced rates are a direct by-product of our ability to assess the payment history and other credit characteristics of our customers – and to reward our customers for their strong performance.

Affiliate sharing is beneficial in combating identity theft and other fraud

Because the exchange of information among affiliates permits financial services companies to monitor customer activities on a company-wide basis, the likelihood of detecting identity theft and other fraud activity is greatly increased.

Affiliate sharing enhances efficiencies and allows lenders to reduce the time and costs of providing their products and services to customers

Affiliate sharing also helps companies to achieve operational efficiencies which further reduce costs and customer hassle. Such sharing allows for the creation of centralized databases to minimize account-management and administrative burdens, including customer service centers capable of handling calls relating to multiple entities and product lines.

The FCRA and Consumer Rights

To ensure healthy competition, the FCRA enacted a number of important consumer protections, including adverse action notice, dispute resolution and consumer disclosure requirements. These protections provided a carefully crafted balance to ensure an efficient and uniform national credit reporting system, while preserving significant consumer rights regardless of where they or the credit grantor is located. An orderly uniform process promotes speed of notice and resolution for consumers.

Balkanized requirements in this area would result in variations in the number of institutions reporting and erosions in credit file quality, with dire consequences for such advances as automated underwriting. If many creditors stop reporting in a jurisdiction or the time frames for resolution are unreasonably compressed to the point where creditors have to drop any challenged information, then the effectiveness of the national system is degraded or harmed irreparably. Ultimately, the losers in this equation will be the consumers, who will pay the price of higher credit costs, reduced availability and less attractive products.

III. Conclusion

Our credit system is the envy of the world. Consistent national credit data is the foundation of this system, ensuring that Americans have more access to credit at lower prices than their counterparts around the globe. It is difficult for many of us to remember what the loan process was like 30, 20 or even 10 years ago. For those lucky enough to get credit cards, you would be guaranteed a flat rate of 19.8 percent and a $20 annual fee. Your card offered no airline miles or other rewards, no affinity programs to benefit your alma mater or favorite charitable organization, no cobranding arrangements to provide you discounts at the retail outlets you visit most often. In the auto world, once you completed the grueling process of negotiating a "fair price" on your new car, you were left to experience the joys of a visit to the dealer's finance desk to negotiate a "fair price" on your loan. In many cases, the dealer was able to recoup his concessions to you on the sale price of the car through a higher APR or hidden fees.

Today, our best credit card customers can enjoy a fixed rate as low as 6.9 percent with no annual fee. The variety of programs and rewards simply boggle the mind. Our auto finance company, PeopleFirst, provides rates as low as 3.89 percent – among the lowest in the nation – online and literally in minutes. The result? Our customers can walk into a dealership fully pre-approved and pre-financed. The dollars you save in your negotiation of the price of your car are yours to keep, and the hours spent waiting (and hoping) for loan approval is a relic of the past.

These tremendous innovations have saved borrowers billions, and Capital One is proud to have played a role in our nation's consumer revolution. Without a doubt, none of these extraordinary developments would have been possible without the FCRA. The FCRA is a vital instrument in preserving the vitality of our credit granting system, and, equally, a vital instrument in preserving the vitality of our modern economy. We urge you to reauthorize these provisions and to extend permanently our national uniform system of credit reporting.

Mr. Chairman, Ranking Member Sanders and Members of the Subcommittee, thank you again for the opportunity to testify before you. I would be happy to answer any questions you may have.

Testimony of

America's Community Bankers

on

The Fair Credit Reporting Act

before the

Subcommittee on Financial Institutions & Consumer Credit

of the

Committee on Financial Services

of the

U.S. House of Representatives

on

June 12, 2003

George B. Loban
Co-Chairman and President
FSF Financial Corporation and First Federal, fsb
Hutchinson, Minnesota

Introduction

Chairman Bachus, Ranking Member Sanders, and members of the Subcommittee, my name is George Loban. I am co-chairman and president of FSF Financial Corporation and First Federal Bank, a $560 million stock institution based in Hutchinson, Minnesota. I am testifying today on behalf of America's Community Bankers, where I serve on the Board of Directors and as chairman of the Privacy Issues Subcommittee.

Thank you for this opportunity to testify on the role of the Fair Credit Reporting Act[1] (FCRA) in the credit granting process. The uniform national standards embodied in the FCRA allow community banks and others to make prudent credit decisions quickly and inexpensively wherever a customer may reside or have conducted business. Reauthorizing these standards on a permanent basis is critical to ACB members, our customers, and the economy as a whole.

My testimony will focus on how community banks use credit report information and how the national credit reporting system established by the FCRA promotes a healthy competitive consumer credit marketplace, while protecting consumer information.

ACB Position

America's Community Bankers strongly supports the uniform national standards embodied in Section 624 of the Fair Credit Reporting Act. We urge Congress to reauthorize this year these uniform standards on a permanent basis. ACB also urges that laws regulating information sharing practices not discriminate against financial institutions based on size or corporate structure.

ACB and its members urge Congress to pass legislation to help community banks and their customers combat identity theft, including new laws to strengthen sentencing standards for identity theft crimes and help prosecutors prove identity theft in courts.

ACB believes consumers should have access to a free annual credit report and enhanced ability to correct errors on their credit reports.

The Fair Credit Reporting Act

The FCRA establishes the legal framework for the collection, use, and maintenance of credit reporting data. It is the foundation for the most effective credit reporting system in the world that enables low-cost and rapid access to consumer credit for today's increasingly mobile society. Initially enacted in 1970, the law was significantly amended in 1996. Among the more significant provisions introduced in 1996, Congress preempted the states from enacting any laws or regulations relating to seven key areas until January 1, 2004. The preempted provisions preclude states from enacting any laws or regulations relating to:

- Prescreened credit solicitations;
- Reinvestigations of disputed information;

[1] Pub. L. No. 91-508 (15 USC 1681-1681t)

- Duties of creditors that take adverse actions;
- Prohibited consumer report information;
- Responsibilities of providers of information to credit bureaus;
- Sharing of information among affiliated companies; and
- Consumer disclosure requirements.

The FCRA facilitates the exchange of credit information that allows community banks and other institutions to make effective lending decisions and provide credit to the widest possible array of consumers. The carefully crafted preemption provisions established in 1996 ensure that credit-reporting information available on consumers is consistent from state to state, facilitating a national market for credit and risk management.

This, however, is scheduled to change if Congress does not act by the end of this year to reauthorize the uniform national standards contained in the FCRA. Failure to act could result in a patchwork of conflicting state laws and substantially erode the quality and integrity of our nation's credit reporting system.

More importantly, it could disrupt our entire economy, a system based on sound credit decision-making. This subcommittee has already heard testimony from a vast array of witnesses representing different sectors of the economy that would be adversely affected by a lapse in FCRA preemptions. As someone who has spent over thirty years making daily business decisions based on credit reports, I can tell you first-hand that the impact of not reauthorizing the FCRA has not been exaggerated.

Sharing Information with Affiliates and Third Parties

The FCRA not only preempts states from enacting laws and regulations relating to the sharing of credit report data among affiliates, but also includes sharing of other information. In today's highly competitive financial marketplace, the ability of affiliates to share information is critical to evaluate customer needs and access their qualifications for new offers. The sharing of information among affiliates also enables valuable customer service features such as consolidated statements and single-source customer call centers across product lines. Moreover, the sharing of information among affiliates can help identify financial transactions that might indicate a customer has become the victim of identity theft.

First Federal Bank has three affiliates with which it shares limited customer information among these entities to market financial products to our customers. In addition to First Federal Bank, the FSF Financial Corporation family of companies includes an investment agency, an insurance agency, and a mortgage lending company with customers in over forty states. By sharing limited information among our corporate family, we are able to better understand the total customer relationship and provide our customers with tailored products and customer support.

The Gramm-Leach-Bliley Act[2] (GLBA) established restrictions and opt out requirements that are primarily directed at information sharing with nonaffiliated third parties. By contrast, the FCRA

---

[2] Pub. L. No. 106-102

information sharing restrictions focus solely on information sharing within a corporate structure. Within a corporate structure the organization has more direct control over how information is used and disseminated, and directly bears the legal and reputation risk in the event that consumer information is misused.

America's Community Bankers strongly supports the FCRA's uniform national standards for financial information sharing. There is no better example of why the preservation of uniform national standard is so critically important than my institution. While First Federal has consumer mortgage customers in over forty states, we are by no measure a large financial institution. If we were forced to comply with forty different state legal frameworks, we would have to hire a team of compliance specialists or turn away out-of-state customers.

Also, the inferior quality of credit data drawn from states operating under multiple collection standards would diminish the general availability of credit. The FCRA's uniform national standards allow First Federal to service mortgage customers effectively nationwide, and at lower cost.

We also urge that laws regulating information sharing practices not discriminate against financial institutions based on size or corporate structure. Many community banks, particularly smaller banks, work with third parties to better serve the needs of our customers to offer financial products. In some cases, these third parties are affiliated institutions (within the same corporate family). In other cases, they are not. In most instances where no affiliation exists, a contractual relationship exists dictating how and what information may be shared.

In regulating the disclosure and opt-out requirements for financial information sharing practices, Title V of the Gramm-Leach-Bliley Act (GLBA) treats certain disclosures of information between a financial institution and a third party identically, regardless of whether the two institutions are affiliated or not. ACB urges that any prospective laws follow suit.

Community Banks and Credit Reporting

Like most community banks, First Federal Bank provides information to each of the three major credit-reporting companies monthly via a data tape produced by our technology service provider. This monthly submission of credit account information contains thousands of activity and status records on all of our customers regardless of their account status. Information found in these credit account records includes key account dates, account balance, payment status, loan type and other basic credit information. This information is passed on without any characterization as to whether such information should adversely affect an individual's credit worthiness or credit score.

With regards to credit scoring, these numbers represent a statistical system used by credit grantors to help assess a credit applicant's creditworthiness. Each of the three major credit-reporting companies has their own proprietary credit-scoring model and credit grantors can only estimate what elements go into determining an individual credit score. While credit scores are a key component for assessing an individual's creditworthiness, they represent only one factor used to determine whether a bank will make a loan. Community banks typically look more broadly at the applicant's entire credit picture and relationship with the bank, and rely less on a credit score than other lenders.

Information found in credit reports comes from a variety of sources. While bank information may represent a significant percentage of the information collected by the three main credit reporting companies, many other sources of credit reporting data exists. Credit reporting companies also receive information from major retailers, utility companies, and medical companies. Additionally, credit-reporting companies gather information from available public records, such as bankruptcy filings, and court issued property liens.

Most community banks do not obtain credit reports directly from one of the three major credit-reporting companies. Rather the typical community bank will contract with a "reseller" organization that consolidates the contents of all of the three major credit-reporting companies into a single report. This provides an easy to use format that can be used to further assess the credit worthiness of an applicant. For lower risk non-mortgage loans, a bank may choose to review information from only one of the credit reporting companies, which is significantly less expensive than a consolidated report.

Safeguarding Confidential Customer Information

Protecting confidential customer information within community banks has long been an institutionalized part of the culture of bank management. Consideration goes beyond simply protecting information within the walls of the institution, it includes protecting information shared with affiliates and non-affiliated third parties alike. All community banks have in place specific programs focused directly on protecting customer information. These include board approved strategies and policies; training and awareness programs; and an assortment of technology solutions. Provisions within the FCRA establish strict restrictions on who may obtain consumer credit report information and how it may be used.

In addition to the FCRA, the Gramm-Leach-Bliley Act; the Expedited Funds Availability Act, and its implementing regulation—Regulation E[3]; and the Right to Financial Privacy Act[4] are examples of federal law designed to protect consumer privacy and restrict unnecessary information sharing. The long history of financial institutions' efforts to protect customer information, along with the legal and regulatory requirements, provides an effective defense system to protect customer information.

Identity Theft

While the U.S. system of credit is clearly the most effective and efficient in the world (due in large part to the national uniformity of information sharing standards), it is not without its glitches. The rising number of identity theft cases is creating enormous hardships on victims and increasing the costs to banks in terms of monetary losses and fraud prevention investments. This continued rise in the number identity theft cases might indicate that something more needs to be done to safeguard information from prospective identity thieves. To that end, ACB urges

[3] 15 U.S.C. § 1693
[4] 12 U.S.C. § 3401-3422

Congress to pass legislation to strengthen sentencing standards for identity theft crimes and make it easier for prosecutors to prove identity theft. We also look forward to working with the Subcommittee on additional legislation to help combat identity theft.

Empowering Consumers to Manage their Credit

Finally, improvements should be made to the credit reporting system itself to help protect consumers from unintended barriers or obstacles to credit. During this year's committee consideration of the regulatory relief bill, Representative Gary Ackermann (D-NY) sponsored an amendment requiring federally insured depository institutions to notify a customer every time it furnishes negative information to a consumer reporting agency. This amendment was withdrawn, but may be offered in the context of the FCRA legislation.

The Ackermann amendment would result in billions of new notices being sent to consumers monthly. This would result in greatly increased costs, not to mention a significant paperwork burden on financial institutions and their customers. ACB and other trade associations opposed the amendment. While we disagreed with Representative Ackermann's proposed solution, we recognize that he may have identified a problem.

The continued integrity of the federal credit reporting system demands that credit reports be as accurate as possible, and ACB is committed to working with Representative Ackermann and other members of Congress toward this goal. ACB supports empowering consumers by providing them access to a free annual credit report and enhancing their ability to correct errors on their credit reports. We recognize that these consumer empowerment tools do not come without some cost to the industry. Nonetheless, we believe these costs will be outweighed by increased consumer trust in the integrity of the system.

Conclusion

Community banks are wholly dependent on the trust of our customers, and this trust represents our most valuable asset. As such, we take extraordinary care to ensure that consumer financial information is safeguarded.

At the same time, community banks depend on our ability to use the information we receive from our customers to deliver the financial services they need.

ACB believes that the twin goals of preserving customer trust and responsibly using customer information are mutually attainable and must be pursued together. We believe that existing federal law strikes the appropriate balance to properly regulate the flow of financial information from a financial institution to affiliates and other third parties.

Again, thank you for this opportunity to testify on behalf of America's Community bankers. I look forward to any questions you may have.

Prepared Statement of

Dr. Robert D. Manning

Caroline Werner Gannett Professor of Humanities

Rochester Institute of Technology

Hearing on "The Role of FCRA in the Credit Granting Process"

Before the Subcommittee on

Financial Institutions and Consumer Credit

The Honorable Spencer Bachus, Chairman

House Financial Services Committee

U.S. House of Representatives

10:00 a.m., Thursday, June 12, 2003 - Rayburn 2128

I would like to thank Chairman Spencer Bachus for providing this opportunity to share my views with the Committee on the increasingly important topic of credit card industry policies and the protection of consumer rights under the Fair Credit Reporting Act. I would also like to commend Ranking Member Bernard Sanders for his efforts in protecting consumers from deceptive marketing and contract disclosure practices of the credit card industry. The twin issues of rising consumer debt and shockingly low levels of financial literacy have grave implications to the continued economic well-being of the nation—especially as Americans cope with these increasing perlilous economic times. For these and many other reasons, I commend the Subcommittee for accepting the daunting task of examining the increasingly serious problem of protecting consumer rights in this period of the rapid deregulation of the financial services industry.

As an economic sociologist, I have spent the last 16 years studying the impact of U.S. industrial restructuring on the standard of living of various groups in American society. Over the last 11 years, I have been particularly interested in the role of consumer credit in shaping the consumption decisions of Americans as well as the role of retail banking in influencing the profound transformation of the U.S. financial services industry. In regard to the latter, I have studied the rise of the credit card industry in general and the emergence of financial services conglomerates such as Citigroup during the deregulation of the banking industry beginning in 1980. In terms of the former, my research includes in-depth interviews and lengthy survey questionnaires with over 800 respondents in the 1990s. The results of this research are summarized in my recent book, *CREDIT CARD NATION: America's Dangerous Addiction to Consumer Credit (Basic Books, 2001).* More recently, I have collected survey data from a case-study of a mid-sized public university based on a representative sample of nearly 800 college students in 2002. Some of the key findings of the study are reported in this testimony. In addition, I have become actively involved in the national movement to improve the financial literacy/education of our youth. My work with colleges, universities, and student loan organizations has inspired my own internet-based financial literacy/education program at www.creditcardnation.com. My next book, *GIVE YOURSELF CREDIT: The Power of Plastic in the Credit Card Nation*, includes my most recent work on several consumer protection cases regarding credit card industry policies as well as my recent surveys on college students.

Banking Deregulation:

From Community Banks to Financial Services Conglomerates

The recent revolution in consumer financial services dates to the 1970s with the increasingly successful assaults against Depression-era banking regulations. For example, the 1933 McFadden Act essentially limited national banks from crossing state boundaries and competing with state-chartered banks. These interstate branch banking restrictions protected the local community banking system and its conservative (asset secured), fixed term "installment" lending policies until the 1980s. Significantly, the best customers of these local banks were those with the lowest outstanding debts whom were most likely to repay their loans within an agreed upon period of time. This is significant today in terms of reviewing the profound changes in the credit screening process and risk assessment models of retail consumer services. That is, the best clients in the regulated, community banking system (pre-1980) were those with low debt-to-income ratios who most likely to repay their loans in-full within a specified period of time.

By the late 1970s, high inflation together with declining real wages encouraged American families to begin embracing consumer debt as a rational strategy for coping with intensifying financial pressures. State usury laws and interstate banking restrictions, however, limited the profitable growth of the universal or "all-purpose" national bank credit card until the 1978 U.S. Supreme Court decision, Marquette National Bank of Minneapolis v. First of Omaha Service Corporation. See Chart 1. For the first time, a nationally chartered bank was allowed to charge the highest interest rate permitted by its "home" state and essentially export these rates to its out-of-state credit card clients. By simply relocating its "bricks and mortar" office to states without consumer usury rate ceilings--Citibank immediately moved from New York to South Dakota--the universal credit card (led by Visa and MasterCard) was transformed into a high profit financial service product that could easily surmount banking barriers. Today, 29 states do not have any limits on the interest rates charged by in-state, credit card issuing banks (Lazarony, 2002).

The universal bank credit card played a major role in the de-regulation of the U.S. banking industry in the 1980s. National "money center" banks faced mounting losses on Third World, residential and commercial real estate loans following the 1981-82 recession as well as the loss of low-cost depositors funds with the end of Regulation Q's fixed passport savings rates. Although Citibank's credit card division lost over $500 between 1979 and 1981, this transitionary period belies the dramatic increase in its profitability following the 1981-82 recession. The sharp reduction in inflation and rapid advances in computer processing technologies underlie the dramatic increase in the profitability of "revolving" loans in the mid-1980s (Nocera, 1994; Manning, 2000). Over the next two decades, these trends precipitated the shift to consumer or "retail" financial services as increased competition through banking "de-regulation" produced higher cost "revolving" or credit card loans. Indeed, the decline in less profitable corporate loans (corporations raise capital directly by selling bonds via Wall Street) contrasts sharply with the rising demand for unsecured, consumer loans; an annual average of 1 million blue-collar workers lost their jobs in the 1980s.

The consumer services revolution shifted into high gear in the 1980s as soaring credit card profits (Asubel, 1991) fueled the unprecedented consolidation of the banking industry. In 1977, for example, the top 50 banks accounted for about one-half of the credit card market (Mandell, 1990). Today, the top 10 banks control over 80 percent of the credit card market (*Card Industry Directory*, 2002). See Table 1. In the process, "net" revolving credit card debt has climbed from about $51 billion in 1980 to over $610 billion in 2002. And, over one-half of outstanding credit card debt is resold in the secondary financial markets as securitarized bonds—at a typical premium of about 18%. This recent trend reduces the risk to credit card issuers (by complex corporate subsidiary structures and complicated insurance schemes) and increases the institutional demand for new "revolving" loans.

Significantly, the re-sale value of unsecured credit card debt has continued to rise during the current recession even though the credit card industry has argued that consumer account default and delinquency rates are hurting its profitability. According to *Business Week*, thirty-seven major credit card portfolios (totaling about $37 billion) were sold at an average premium of 18.4% in 2002 and twenty deals ($4.1 billion) have averaged 18.99% in 2003. The reporter noted that this impressive premium for unsecured consumer debt was rising "despite high delinquency rates, rising unemployment, and escalating bankruptcies that heighten their risks" (Weber, 2003:70). . The result is the industry has intensified marketing campaigns to recruit new customers and encourage higher household debt levels. In the process, these industry pressures have profoundly changed the credit card industry's "pre-screening" policies and preferred client characteristics.

The industry's effort to increase its "revolving" debt portfolio is illustrated by the enormous increase in credit card solicitations and extended "lines" of revolving credit. For example, BAI Global reports that between 1997 and 2001, the number of mailed credit card solicitations rose 66.7 percent: 1997 (3.0 billion), 1998 (3.4 billion), 1999 (2.9 billion), 2000 (3.5 billion), and 2001 (5.0 billion). During this period, however, consumer response rates to these mass mailing declined from 1.3% in 1997 (3.9 million applications) to 0.6% in 2001 (3.0 million applications). Significantly, the reduction in the annual growth rate of the credit card industry's client base has fueled issuers' efforts to increase the debt "capacity" of their accountholders by raising available lines of credit. For instance, credit card debt (gross) rose 31.8% between 1997 and 2001 (from $554 billion to $730 billion) whereas total revolving lines of credit card jumped 75.0 percent from $1.667 billion to $2.917 trillion. The enormous increase in extended credit belies consumer demand as utilization of the revolving lines of credit dropped from 33.2 percent in 1997 to 25.0 percent in 2001. This trend continues today as consumer credit card debt declined during the first quarter of 2002 and yet aggregate revolving credit rose $262 billion (US Federal Reserve Board, 2002 and Veribanc Inc, 2002 as cited in CFA, 2002).

Not surprisingly, the credit industry began aggressively marketing previously neglected, economically marginal consumers in the 1990s. Significantly, the screening process essentially turns on its head the screening criteria for marketing to traditionally neglected groups such as college students and the working poor. That is, these potential clients were screened based on their underutilized "debt capacity" and the industry's assessment that they would be unlikely to payoff their debts in the near future. For example, the longitudinal Survey of Consumer Finance (conducted by the University of Michigan) shows that the largest increase in consumer credit card debt is among households with a reported annual income of less than $10,000. Between 1989 and 1998, the average credit card debt among households that revolve their credit card balances increased a moderate 66.3 percent versus 310.8 percent for the poorest households—from $598 in 1989 to $2,440 in 1998. Similarly, households headed by seniors (over 64 years old) experienced a dramatic increase of 140.9 percent, from $1,497 in 1989 to $3,607 in 1998 (reported in Draut, 2003; Manning, 2003b). See Table 2.

The aggressively marketing of college students has been reported elsewhere (PIRG, 1998; 2000; Manning, 1999; Manning, 2000:Ch. 6; 2002) with growing attention to the poor financial literacy of America's youth (Mandell, 1998; 2000; 2002; Manning, 2002). What is striking is the acknowledgement of the credit card industry is that college students are a desirable market because of their ignorance of personal finance and their lack of consumer debt. As shown in Table 3, the marketing of credit cards has shifted rapidly over the last five years from college upperclassmen to college freshmen and high school seniors. More significantly is the recognition that student consumption has a large debt component that is increasingly financed by family loans, federally subsidized student loans, summer earnings and part-time employment during the academic year, and even with other credit cards. As shown in Table 3, three out of five students with credit cards in our survey had already maxed them out during their freshmen year and, 3 out of 5 freshmen with multiple credit cards were already using bank cards to pay for other revolving credit accounts. Furthermore, this survey reveals that nearly three-fourths of students use their student loans to pay for their credit cards. Not incidentally, recent studies indicate that this indiscriminate marketing to college students has led to high incidences of fraud and identity theft among this young adult population.

Assessing the Deregulation of Consumer Financial Services: Soaring Profits and Spiraling Costs

Not surprisingly, the credit card industry has reported record profits this year. According to the most recent FDIC report (June 2003) on bank profits, [First Quarter 2003] "is the largest quarterly earnings total ever reported by the [banking] industry... [and] the largest improvement in profitability was registered by credit card lenders [with] their average Return-On-Assets (ROA) rising to 3.66 percent from 3.22 percent a year earlier." The extraordinary profitability of consumer credit cards is illustrated by comparing the ROA of credit card issuers with the overall banking industry. According to the FDIC, the increase in the ROA for the banking industry rose from 1.19% in 1998 to 1.40% in 2003 (First Quarter) or 17.6%. According to the U.S. Federal Reserve

Board, ROA for the credit card industry was 2.13% in 1997 and has risen impressively to 2.87% in 1998, 3.34% in 1999, 3.14% in 2000, 3.24% in 2001, 3.5% in 2002, and 3.66% in 2003 (First Quarter). This is largely due to lower cost of borrowing funds (widening "spread" on consumer loans), decline in net charge-offs ($911 million or 18.5 percent lower in 2003 than 2002), decline in delinquent accounts ($919 million or 14.3 percent lower in 2003 than 2002), cross-marketing of low-cost insurance and other financial services, and dramatic increase in penalty and user fees.

The most striking feature of the deregulation of the U.S. banking industry is the sharp increase in the cost of unsecured "revolving" credit. For instance, the 'real' cost of borrowing on bank credit cards has more than doubled due to widening interest rate "spreads" (doubled from 1983 to 1992) and escalating penalty and user fees (cf. Manning, 2000:Ch. 1). The latter is attributed to the 1996 U.S. Supreme Court decision, Smiley v Citibank, which ruled that credit card fees are part of the cost of borrowing and thus invalidated state imposed fee limits. Overall, penalty fee revenue has climbed from $1.7 billion in 1996 to $7.3 billion in 2001. The average late fee has jumped from $13 in 1996 to $30 in 2002. Incredibly, combined penalty ($7.3 billion) and cash advance ($3.8 billion) fees equaled the after-tax profits of the entire credit card industry ($11.13 billion) in 2001. See Table 4.

This dramatic increase in credit card fees following the 1996 Smiley decision is illuminated by information grudgingly released during ongoing litigation with a major credit card issuer concerning alleged abuse of a consumer's rights under the FCRA. As shown in Table 5, this regional bank's total, nonfinance-related revenues jumped from $28.98 million in 1994 to $31.57 million in 1996 (new fee structure imposed in second half of the year) and then to $73.03 million in 1997 and then to $76.03 million in 1998 when its acquired by FirstUSA credit card company (Bank One). During this period, late fee revenues nearly tripled from $10.49 to $29.20 million, overlimit penalty fees jumped from $4.93 (1996) to $15.22 million, returned check fees climbed from $0.20 to $2.85 million, and new credit life insurance soared to over $7 million. It is the outrageous imposition of costly credit card fees and the aggressive solicitation of new clients (especially college students, working poor, and seniors) that underlies the "plant, squeeze, and sell" strategy of regional banks whose primary goal is to increase their credit card revenues in order to maximize the eventual sale price of their credit card division to a top ten issuer (Manning, 2004).

Today, the ascension of the Credit Card Nation features the shift from installment to revolving loans where the best bank customers will never repay their high interest credit card balances. Unlike the installment lending system, the most economically disadvantaged (debtors) essentially subsidize the low cost of credit to the most economically advantaged (convenience users). It is this "Moral Divide" that leads banks to refer to 'deadbeats' as those clients whom pay off their charges in-full each month. These largely unprofitable accounts (depending on monthly charge volume and rebate/reward programs) increased substantially in the last decade, from 29 percent in1991 to 37 percent in 1996 and then peaking at 43 percent in 1999 (Manning, 2000). In 2003, less than 40 percent of credit card household pay off their balances in-full. As shown in Table 6, these accounts can be quite costly to banks that are not successfully cross-marketing other financial services products to these customers. For example, based on 2001 account expenses and revenues, a typical grocery store affinity cardholder (average charges of $700 per month) with a 1% cash reward program cost First USA about $51 for the year plus average cost of charge-offs per account in 2001 of $95. A disturbing trend in this period of credit card industry consolidation is the rise of "cherry picking" of profitable accounts. That is, even with the rising proportion of profitable "revolvers," many banks are seeking to screen out financially responsible "deadbeats" by not renewing their accounts or charging membership fees.

The escalating profits of the credit card industry underlie the increasing dependence of corporate retailers on finance revenues due to shrinking margins on consumer sales. In 2001, for instance, Sears and Circuit City reported that over one-half of their corporate profits were due to finance-related revenues. For instance, most consumers are not aware that "12 months interest free, same as cash" promotions feature a surprise at the beginning of the 13th month—all finances charges are retroactive if the account is not paid in full. See "Ann's" experiences with Home Depot's private issue credit card which is provided by Citibank in Appendix B. This is not surprising since credit cards are the most profitable product of the financial services industry. Even during the current recession, pre-tax profits of the credit card industry (measured by

Return on Assets) jumped 20% from 2000 to 2001. As reported in Table 2 below, the nearly $18 billion in pre-tax profits is an industry record. Not incidentally, the growing burden of high-cost credit card debt is disproportionately borne by middle-income and working poor families. Among the three out of five "revolver" households in the United States, their average credit card debt is staggering, rising from over $10,000 in 1998 to over $12,000 in 2002. These figures do not include the $1 trillion in outstanding, nonmortgage consumer installment debt, lease contracts (automobiles), and loans from the "Second Tier" financial sector including pawnshops, "payday lenders, and rent-to-own stores.

The Deregulation of Financial Services:
The Future of Consumer Rights

The current recession, which has elicited President Bush's patriotic exhortations to spend more time and money in the malls, has highlighted the critical role of consumer spending to the vitality of the U.S. economy. Although government policy-makers have encouraged household spending by reducing interest rates (Federal Funds rate was cut from 6.5% in 2000 to 1.75% at end of 2001), the sharp decline in the cost of borrowing by banks has not been passed on to consumers. For the major credit card companies, the Federal Reserve's low-interest rate policy has produced a financial windfall since "sticky" credit card rates declined only modestly--from an average of 18% in 2000 to about 16% in 2001 and nearly 15% in 2002. This trend was the focus of this Subcommittee's hearing "Abusive Credit Card Industry Practices" that was held on November 1, 2001

As shown in Table 2, interest revenues barely dipped from $64.6 billion in 2000 to $64.2 billion in 2001 (with an 8% increase in outstanding debt) whereas bank borrowing costs dropped steeply from $28.6 to $20.5 billion—more than compensating for the $5.2 billion increase in credit card debt charge-offs. And, as illustrated by ongoing litigation, Wells et al v. Chevy Chase F.S.B., any state regulation of credit card interest rate ceilings and fees will be aggressively resisted as well as the requirement of "meaningful notice procedure" for contract amendments. In this case, Maryland-based Chevy Chase Bank promised its credit card clients not to raise the top interest rate above 24%. In 1996, it moved its credit card headquarters to Virginia and raised its interest rate to a high of 28.8%. It also amended the terms of its contract to include higher late fees, a new overlimit fee, and a more costly "daily" calculation of finance charges without proper notification for clients to reject these unfavorable amendments to their existing contracts.

The credit card industry is so determined to protect the high profits derived from its most indebted clients that, in Lockyer et al v. American Banking Association et al (under appeal), it sued to prevent the enactment of a state disclosure statute. The 2002 California law simply requires banks to inform those clients that remit only the minimum credit card payment of the number of years necessary to pay off their outstanding balance (assuming no additional charges) in a notation on their monthly account statement. The goal of the legislation is to educate consumers about the long-term cost of their revolving credit accounts and thus encourage a shorter and less expensive repayment period.

Although banks emphasize the availability of low-interest balance transfers, the most indebted rarely qualify for these promotional programs ('bait and switch' offers) or benefit for only a short period of time (two to six months). Furthermore, credit card companies have adopted a stringent policy of imposing punitive financial penalties on promotional interest rates for minor payment infractions or simply due to high outstanding balances on other consumer loan accounts.

In Houston, Texas, for example, Doug received an enticing six month, 1.9% balance transfer offer from Chase MasterCard and shifted $5,000 from his MBNA credit card account. Unfortunately, Doug's wife mistakenly sent $80 instead of the required $97 for the first month's minimum payment. Even though it was received two weeks before the due date, his next statement reported $17 past-due plus a $35 late fee. More striking was the increase in the interest rate, from 1.9% to 22.99%, even though he had not had a late payment in over two years. In an attempt to negotiate a lower finance rate, Doug was informed by a Chase customer service representative that he would have to document six consecutive months of on-time payments before his request could be considered. This followed an earlier "bait and switch" from Chase where the 4.9% promotional rate was raised without warning simply because the bank had decided that the cumulative balances on his other credit cards was "too high." How high is too high is an answer that the banks will not explain.

Some sophisticated "reward" programs lure customers with attractive rebates that are much less generous than implied in the marketing brochures. For example, the Student Visa card issued by Associates National Bank of Delaware (recently acquired by Citibank) proclaims, "Get Up to 3% Cash Back on Purchases." Rosa, a law student at William and Mary University in Virginia, considered it a potentially prudent choice since she usually pays off her account balance each month. Upon reading the fine print, which qualified the terms of the agreement, she realized the true cost of Citibank's benevolence: "For the times when you carry a balance from statement to statement, we'll help you by giving you up to 3% cash back on the amount of the net purchase." Hence, Rosa would rarely qualify for the cash back rebate. And, when she did, Rosa would have to pay an annual finance charge that ranged from 14.74% to 24.74%.

In Orlando, Florida, Jolynn was offered a $10 discount coupon at the Costco Wholesale Club for applying for a co-branded American Express card. The card featured a 0% interest rate on purchases for the first 3 months (1.99% balance transfer for six months) and 12.74% thereafter plus "up to 2% cash back." The latter was most appealing until she read the tiered structure of the reward program: less than $2,000 annual charges, 0.75% cash back (0.25% without balance), $2,000 to $5,000 annual charges, 1.00% cash back (0.50% without balance), and over $5,000, 2.00% cash back (1.50% without balance). Unless Jolynn carried a monthly balance or charged over $5,000 per year, she would not receive even a 1.0% cash rebate.

An especially egregious policy is the unilateral increase of a consumer's credit card interest rate because of cumlative balances on other accounts, even when the contract specifies "fixed interest rates for the life of the loan." For example, Wally, who has an MBA degree and lost his six figure job in the financial services industry in the aftermath of the destruction of 9/11, has three credit cards with a cumulative balance of $17,000. All three cards were obtained through zero "balance transfer offers." Today, with a $55,000 annual salary and $73,000 in student loans, Wally considers himself an indentured servant with an average annual interest rate of over 23 percent. Even though he has not been late with a credit card payment in over 1 ½ years, the banks (Chase, Citibank, Discover) refuse to lower his interest rates. In fact, they told him to make an appointment with a consumer counseling agency or file for bankruptcy if he does not want to pay these high finance rates.

The most costly credit cards are marketed to the working poor. In its direct mail solicitation, United Credit National Bank Visa declares, "ACE VISA GUARANTEED ISSUE or we'll send you $100.00! (See inside for details.)" For John, a 55 year-old African American who lives on public assistance in suburban Maryland near Washington, D.C., the terms of this contract are outrageous,

> "Initial credit line will be at least $400.00. By accepting this offer, you agree to subscribe to the American Credit Educator Financial and Credit Education Program. The ACE program costs $289.00 plus $11.95 for shipping and handling plus $19.00 Processing Fee a small price to pay compared to the high cost of bad credit! The Annual Card Fee [is] $49.00... For your convenience, we will charge these costs to your new ACE Affinity VISA card. [They] are considered Finance charges for Truth-In-Lending Act purposes."

For unsuspecting applicants like John, this credit card will cost $369 for a net credit line of only $31 at 19.8 APR. It is no wonder that those households whom are most desperate for consumer credit often give up on the financial services sector after they realize the exploitative terms of these contracts.

The passage of the Financial Services Modernization Act of 1999, which consecrated the Citibank and Traveler's Group merger, marks the end of Depression-era regulation of retail banking as separate from commercial banking/insurance services. It is the emergence of financial services conglomerates such as Citigroup that was the catalyst for the plethora of recent Wall Street financial scandals. Moreover, the ability to acquire companies across financial services sectors and share client information with corporate subsidiaries underlies the rise of "cross-selling" financial products such as investment services to credit card clients. This explains Citibank's 1997 purchase of AT&T's unprofitable credit card company (8th largest), at a substantial premium, with its large number of high income customers. For Citigroup, this corporate synergy produces multiple revenue flows by originating high interest loans through its credit card

(Citibank) and subprime lending (First Capital Associates was acquired in 2000) subsidiaries which are then resold through its investment division of Solomon Smith Barney (cf. Hudson, 2003; Manning 2003a).

Not incidentally, access to personal consumer credit information enables predatory lenders to identify highly indebted households that are susceptible to duplicitous debt consolidation solicitations. In Acorn v Household Finance Corporation, a California suit filed in 2002, lists of prospective clients were obtained from affiliated retailers including Best Buy, Wickes Furniture, K-Mart, Costco, and Home Base. Homeowners with high credit card and other consumer debts were identified from these lists and contacted by account executives at nearby branches. Potential customers were promised that their debt consolidation loans would save them money after the refinancing of their credit card, consumer loan, and mortgage debts. In the process, the objective of this 'target practice' was to deliberately 'upsell' loans in amounts so high in relation to the value of the borrowers' homes that it would be nearly impossible to sell or refinance them in the future. By misrepresenting the total cost of these debt consolidation loans (origination fees, mandatory insurance, high interest rates), Household Finance Corporation generates high profits from the initiation of these loans as well as from their resale in secondary mortgage and securitarized bond markets.

Today, high credit card interest rates are no longer sufficient to satisfy the voracious appetite of the financial services industry. Penalty and transaction fees continue to rise while new fees are imposed such as overdraft transactions, foreign currency conversion, and "double billing" cycles which reduce the payment "grace" period. In addition, banks have begun aggressively marketing financial-related services that offer little practical benefits for their clients including credit protection programs ($9.99 per month from Citibank) that can not prevent identity fraud, unemployment and injury insurance (typically 0.5% of outstanding monthly balance) that provide minimum credit card payments that rarely can exceed premium payments, and other forms of low-value term-life and health insurance. The proliferation of these credit information and insurance products yield very high profits for the banks and only modest benefits for consumers.

As for future statutory regulation and other consumer protections, local and state attempts have been aggressively thwarted through the creative use of Federal Preemption. That is, the U.S. Constitution specifies that public efforts to regulate the operation of a national banking system can only be legislated by the U.S. Congress to the exclusion of local and state jurisdictions. The tremendous political influence of the banking industry on both the Executive Branch (MBNA was the largest contributor to George Bush's Presidential campaign) and the U.S. Congress (especially Senate Banking and House Financial Services Committees) ensures that there will not be any significant pro-consumer bills enacted in the next couple of years. In addition, the credit card industry's recent imposition of binding arbitration is designed to drastically curtail class action lawsuits. The legality of mandatory arbitration and thus the future of consumer litigation against unfair lending policies by the credit card industry is being challenged with varying degrees of success by several ongoing lawsuits.

Lastly, with the twin threat of statutory regulation and class action litigation greatly diminished, the current focus of the credit card industry is the enactment of the Bankruptcy Reform Act. Vetoed by President Clinton at the end of 2000, versions of this aggressively lobbied pro-banking bill were passed by the U.S. House and Senate during the last Congress. The objective of the bill is to increase the amount of unsecured consumer loans (especially credit card debts) that must be repaid before the approval of a bankruptcy petition. If this bill is enacted into law, it will expand the U.S. government's role as a *de facto* debt collector and increase the costs assumed by the public in extending consumer credit to the most risky credit card clients. Hence, it will provide a <u>dis</u>incentive for the banks to curtail the marketing of high-cost credit to its most marginal clients. For an industry whose motto is "Greed is Good," this legislative distortion of the free market system constitutes the final piece of the puzzle for sustaining its record profits and spiraling executive bonuses. As shown in Table 7, this compensation mix is incredibly lucrative for credit card industry executives whose total mean compensation in 2002 averaged $20.23 million, led by Alfred Lerner of MBNA at $195.00 million (Punch, 2003).

Chart 1

Federal Regulation of the Credit Card Industry

1978 **Marquette National Bank of Minneapolis v. First National Bank of Omaha**: U.S. Supreme Court decision permits national banks to move their headquarters to states with high interest rate ceilings and thus evade federal interstate banking restrictions and state usury laws. By essentially "exporting" high finance rates to states with strong pro-consumer rate protections, a national market for bank credit cards is created. Citibank immediately moves its headquarters from New York City to Sioux Falls, South Dakota. Today, 29 states do not have interest rate caps on credit cards.

1996 **Smiley v. Citibank**: U.S. Supreme Court voids state regulations on credit card related fees such as late and overlimit penalty fees. The ruling specifies that fees are part of the cost of financing consumer credit and can only be regulated by U.S. Congress. Between 1996 and 2001, credit card penalty fees soar from $1.7 to $7.3 billion.

1999 **College Student Credit Card Protection Act**: First introduced in 1999, the legislation proposes restrictions on marketing credit cards to college students under 21 years old and to impose low credit limits on students under 21 years old without demonstrable sources of income and whose parents will not co-sign the credit card contract. Bill is denounced by banking industry and is defeated in the U.S. House of Representatives.

1999 **Wells et al v. Chevy Chase Bank, FSB** (under appeal): Regional Credit Card Company blatantly disregards existing contract with card accountholders by moving its headquarters to Virginia in 1996 and raising interest rates (high of 28.8%), imposing new fees, higher daily interest rate calculation, mandatory arbitration, and purposively fails to provide meaning notice procedure for disclosure of new contract terms. Bank argues that federal preemption denies plaintiffs' the legal right to seek relief.

1999 **Financial Services Modernization Act:** Essentially ends Depression-era regulation of U.S. banking industry by permitting Citibank to merge with Traveler's Insurance Group into a single conglomerate, Citigroup. The Act rescinds most interstate branch banking restrictions as well as "firewall" protections between retail (consumer services) and wholesale (investment) banking activities. The goal is to facilitate "one-stop" banking and pursue "cross-marketing" strategies. Citibank purchases AT&T credit card company in 1998 and Citigroup acquires First Capital Associates in 2001.

2000 **Deaton v. Chevy Chase Bank, FSB** (under appeal): Plaintiff is billed five-fold for purchases incurred on a business trip in 1994 even though the merchants verify consumer's claim. Under FCRA, plaintiffs demands corrections to her credit report which are ignored. In 1997, plaintiffs account file is lost" during sale of credit card company to First USA and additional late fees and legal expenses are billed by First USA. The case raises serious questions regarding how banks respond to FCRA obligations and how illegally obtained "other" revenues are deposited and classified for accounting purposes.

2002 **Lockyer et. al. v. American Banking Association et. al.** (under appeal): Credit Card industry files injunction against enactment of a bill passed by the California state legislature that requires credit card companies to clearly state how many years it will take for a consumer to pay off the outstanding balance if only the minimum payment is submitted. Litigation demonstrates the credit card industry's intent to resist legislative efforts to inform consumers about nonfinance related issues such as disclosure of specific contract terms and payment information.

2003 **Acorn v. Household Finance Corporation** (pending): The predatory "trolling" for heavily indebted consumers by identifying households with high levels of credit card and other unsecured debt. These consumers are persuaded to consolidate their unsecured debts with existing home mortgages into a single high interest loan. By "upselling" loans above the value of their homes, the consumer is typically unable to seek more favorable refinancing with other banks and unable to sell their home in the future.

2003 **Consumer Bankruptcy Reform Act**: This bill, which was vetoed by President Clinton in 2000, is primarily promoted by the credit card industry. The goal is to prevent more petitioners from seeking relief through debt liquidation (Chapter 7) by pushing them into a repayment plan (Chapter 13). Debate is still unresolved over the Homestead Exemption provision (five states including Texas permit protection of all home equity) and consumer advocates are seeking to deny banks priority status over personal obligations such as child support and alimony. Higher cost of filing and administration will deny the most disadvantaged an option to file for bankruptcy. Also, it shifts some of the costs of debt collection to the public and thus limits the banks' financial risk of marketing to low income and highly indebted consumers. Credit card giant MBNA was the largest financial contributor to George W. Bush's presidential campaign.

Table 1

Top Ten U.S. Credit Card Issuers:
Account Balances, Charge Volume, and Customer Accounts[a]

(December 31, 2001)

Rank	Name	Balances ($ billions)	Volume ($ billions)	Accounts[b] (millions)
1	Citibank	108.9	218.5	92.9
2	MBNA America	74.9	142.3	50.9
3	First USA/Bank One	68.2	140.4	39.4
4	Discover	49.3	93.3	50.3
5	Chase	40.9	70.9	24.0
6	Capitol One	38.4	50.6	38.9
7	American Express	32.0	224.6[c]	34.6[c]
8	Providian	32.9	30.5	19.1
9	Bank of America	27.2	48.9	14.5
10	Household Bank	16.1	34.9	17.9

[a]Total of charges during year (January 1 – December 31, 2001).

[b]Includes multiple accounts of same households.

[c]Includes American Express charge and credit card (Optima) accounts.

SOURCE: CardWeb.com, Inc available at www.cardweb.com.

Table 2

AVERAGE FAMILY CREDIT CARD DEBT:

Revolving Debtor Households by Income and Age (1989 – 1998)*

(Reported in 1998 Dollars)

HOUSEHOLD INCOME	1989	1992	1995	1998	% Change (1989-98)
Less $10,000	$594	$1,318	$1,503	$2,440	310.8%
$10,000 - $24,999	$1,443	$1,923	$2,399	$2,745	90.2%
$25,000 - $49,999	$2,240	$2,658	$2,809	$3,976	77.5%
$50,000 - $99,999	$2,948	$3,306	$3,684	$4,628	57.0%
Over $99,999	$5,107	$5,723	$6,384	$7,335	43.6%
ALL FAMILIES	$2,482	$2,753	$3,153	$4,129	66.3%
Older Households Head (55-64 yrs)	$2,400	$2,557	$3,120	$4,931	105.5%
Head (Over 65 yrs)	$1,497	$1,973	$1,698	$3,607	140.9%

SOURCE: University of Michigan Survey of Consumer Finances (SCF), 1989, 1992, 1995, and 1998 as reported in Tamara Draut, *"Trying to Make Ends Meet: The Growth of Credit Card Debt,"* (New York: Demos Final Report, 2003).

*Data analysis excludes "convenience users" whom are defined as accountholders without any outstanding credit card balances.

Table 3

STUDENT LOANS, AGE OF FIRST CREDIT CARD, MAXED CREDIT CARD LIMIT, & USED CREDIT CARDS TO PAY FOR OTHER CREDIT CARDS BY CLASS STANDING

George Mason University (April 2002)

	FRESHMEN	SOPHS	JUNIORS	SENIORS*
	(N=117)	(N=102)	(N=120)	(N=161)
AGE OF FIRST CREDIT CARD (77.4% undergraduates have bank credit cards)				
16 and under	12.3%	5.8%	5.7%	5.0%
17	17.7%	10.1%	10.4%	5.0%
18	56.2%	56.5%	38.7%	45.4%
19	11.0%	14.5%	20.7%	14.9%
20	0.0%	2.9%	13.2%	9.2%
21	0.0%	1.5%	2.8%	8.5%
22	1.4%	5.8%	1.9%	2.8%
23 and over	1.4%	2.9%	6.6%	9.2%
TOTALS	100.0%	100.0%	100.0%	100.0%
MAXED OUT CREDIT CARDS (73.4% undergraduates)				
Yes	59.7%	77.9%	71.2%	80.0%
No	40.3%	22.1%	28.8%	20.0%
TOTALS	100.0%	100.0%	100.0%	100.0%
USED CREDIT CARDS TO PAY OTHER CREDIT CARDS (66.0% undergraduates)				
Yes	58.1%	67.7%	64.2%	70.6%
No	41.9%	32.3%	35.8%	29.4%
TOTALS	100.0%	100.0%	100.0%	100.0%

*Includes students who have matriculated at least four or more years.

Table 3

	FRESHMEN	**SOPHS**	**JUNIORS**	**SENIORS***
	(N=117)	(N=102)	(N=120)	(N=161)
STUDENT LOANS (45.0% received)				
Yes	33.6%	41.2%	40.0%	52.8%
No	66.4%	58.8%	60.0%	47.2%
TOTALS	100.0%	100.0%	100.0%	100.0%
CREDIT CARDS (77.4% undergraduates)				
Yes	62.4%	65.7%	87.5%	88.2%
No	37.6%	34.3%	12.5%	11.8%
TOTALS	100.0%	100.0%	100.0%	100.0%
USED STUDENT LOANS TO PAY DOWN CREDIT CARDS (68.3% or 112/164)				
Yes	73.3%	74.2%	70.5%	63.5%
No	26.7%	25.8%	29.5%	26.5%
TOTALS	100.0%	100.0%	100.0%	100.0%

*Includes students who have matriculated at least four or more years.

Table 4

Bank Credit Card Profitability: 2000-2001
(Billions of US Dollars)

Revenues	2001	% Change From 2000	As % of Ave Outstandings	2000
Interest	$64.2	-1.0%	12.7%	$64.6
Interchange	$14.1	7.0%	2.8%	$13.2
Annual Fees	$2.4	5.0%	0.5%	$2.3
Penalty Fees	$7.3	11.0%	1.5%	$6.6
Cash Advance Fees	$3.8	12.0%	0.8%	$3.4
Enhancements*	$0.6	5.0%	0.1%	$0.6
TOTALS	$92.5	2.0%	18.3%	$90.7

Expenses	2001	% Change From 2000	As % of Ave Outstandings	2000
Cost of Funds	$20.5	-28.0%	4.1%	$28.6
Charge-offs	$29.9	21.0%	5.9%	$24.7
Operations/Mrkting	$23.8	8.0%	4.7%	$22.1
Fraud	$0.7	8.0%	0.1%	$0.7
TOTALS	$74.8	-2.0%	14.8%	$76.0
Pre-Tax Profit/ROA	$17.7	20.0%	3.5%	$14.7
Taxes**	$6.54			$5.44
After-Tax Profit/ROA	$11.13	20.0%	2.2%	$9.26
Ave Outstandings	$505.34	7.7%		$469.10

Sources: Card Industry Directory 2003 Edition (Thompson Publishers, June 2002) and James J. Daly, *"A Little Help From Uncle Sam, Government Intervention Never Looked Better Than It Did in 2001,"* Credit Card Management, March 2002, pp. 3-7

*Enhancements include marketing revenues from third party retailers, insurance premiums, and returned check fees.

Table 5

NonFinance Credit Card Revenues and Rebate Expenses:

East Coast Regional Bank (1994-1998)
(Millions of Dollars)

REVENUES (Fees)	**1994**	**1995**	**1996**	**1997**	**1998**
Membership	$5.19	$1.54	$3.70	$6.11	$7.19
Merchant	$10.63	$6.43	$1.21	$10.91	$11.41
Late Penalty	$10.49	$3.12	$15.28	$25.47	$29.20
Over Limit	---	---	$4.93	$13.39	$15.22
Cash Advance	$2.47	$1.23	$5.69	$6.20	$3.04
Returned Check	$0.20	$0.31	$0.76	$1.66	$2.85
Credit Life Insurance	---	---	---	$9.29	$7.12
TOTALS	**$28.98**	**$12.63**	**$31.57**	**$73.03**	**$76.03**
Rebate Expenses	$13.44	$5.52	$4.73	$6.25	$15.04
NET REVENUES	**$15.54**	**($7.11)**	**$26.84**	**$66.78**	**$60.99**

SOURCE: Discovery documents from defendant in ongoing FCRA civil suit (2003).

Table 6

Are You A Credit Card 'Deadbeat'?:

Typical *GIANT* Supermarket Affinity Account: 2001*

(First USA Bank)

($700 volume of charges per month)		
INTERCHANGE FEES	$142.80	$142.80
BANK's COST OF FUNDS	-$28.35	-$28.35
1% CASH REBATE Program	-$84.00	**Without Rebate Program**
MARKETING/OPERATING EXPENSES	-$81.30	-$81.30
Subtotal	**-$50.85**	**$33.15**
AVE COST OF CHARGE-OFFS	-$95.15	-$95.15
Net Cost per Deadbeat Account	**-$146.00**	**-$62.00**

($1,000 volume of charges per month)		
INTERCHANGE FEES	$204.00	$204.00
BANK's COST OF FUNDS	-$40.50	-$40.50
1% CASH REBATE Program	-$120.00	**Without Rebate Program**
MARKETING/ OPERATING EXPENSES	-$81.30	-$81.30
Subtotal	**-$37.80**	**$82.20**
AVE COST OF CHARGE-OFFS	-$95.15	-$95.15
Net Cost per Deadbeat Account	**-$132.95**	**-$12.95**

Sources: Card Industry Directory 2003 Edition (Thompson Publishers, June 2002) and James J. Daly, *"A Little Help From Uncle Sam, Government Intervention Never Looked Better Than It Did in 2001,"* Credit Card Management, March 2002, pp. 3-7

*Based on 2001 industry averages of 1.7% interchange fee, 4.05% cost of funds, 4.7% combined cost of marketing and operating expenses (as a percentage of managed receivables, and 2001 First USA charge-off rate of 5.5% of managed receivables.

Table 7

Highest Paid Card-Industry Executives: 2002

(Compensation includes Salary, Bonus, and Stock Options in millions)

Rank	Name	Title	Company	Total Pay
1	Alfred Lerner	Chairman & CEO	MBNA	$195.01
2	Charles M. Cawley	Pres & CEO	MBNA	$49.08
3	Charles T. Fote	Chairman & CEO	First Data	$39.22
4	John R. Cochran III	V. Chairman	MBNA	$36.16
5	Bruce L. Hammonds	V. Chairman	MBNA	$28.80
6	Kenneth I. Chenault	Chairman & CEO	American Ex	$18.30
7	Robert B. Willumstad	Pres, Global Consumer	Citigroup	$9.78
8	Pete J. Kight	Chairman & CEO	CheckFree	$7.89
9	James M. Cracchiolo	Pres, Global Fi Services	American Ex	$7.81
10	Ronald V. Congemi	SVP, Network Services	Concord EFS	$5.43
11	Alfred F. Kennedy	Group Pres, US Consumr	American Ex	$5.29
12	Thomas F. Chapman	Chairman & CEO	Equifax	$4.40
13	Gary L. Crittenton	EVP & CEO	American Ex	$3.43
14	Matthew J. Bannick	SVP, Global Online Pay	eBay	$2.90
15	Phillip G. Heasley	EVP	Bank One	$2.48
16	Joseph W. Saunders	Chairman, Pres, CEO	Providian	$2.41
17	Warren Wilcox	V. Chairman, Marketing	Providian	$2.37
18	Susan Gleason	V. Chairman, Ops & Sys	Providian	$2.33
19	Ronald N. Zebeck	Chairman & CEO	Metris	$2.23
20	Ellen Richey	V. Chairman, Risk Mgnt	Providian	$1.79
21	Paul J. Liska	EVP, Credit & Fin'l Prods	Sears	$1.52

Sources: Standard & Poor's ExecuComp cited in Linda Punch, "Fading Pay," Credit Card Management, June 2003, p. 42.

Appendix A

CREDIT CARD NATION: Historical Anomalies of Post-Industrial America

[1] More Profitable to Finance Consumption than to Produce/Sell Commodities such as *Circuit City* (electronics) and *GE Finance Corporations.*

[2] The Most Desirable Clients of the Financial Services Industry Are Those Unable To Repay Their Loans. Conversely, Customers That Pay-Off Their Credit Card Charges Each Month Are Least Desirable and called 'DEADBEATS.'

[3] The lowest Income and most financially Distressed "Revolver" Credit Card Users Subsidize the Most Affluent and Financially Advantaged "Convenience Users" (Moral Divide).

[4] Banks Prefer to Reject Loans to Small Businesses, the Primary Source of New Jobs, With the Expectation that They Use High Interest Credit Cards; Today, Credit Cards are the Number One Source of Start-Up Capital for Entrepreneurs.

[5] First Credit Card is More Likely to Be Received Before First Full-Time Job For Most College Students. Hence, Most College Students Perceive Credit Cards as an Entitlement Rather Than an Earned Privilege With Financial Responsibilities.

[6] Since 1980, the Deregulation of the Banking Industry has Produced High Cost "Financial Products" that Defy Traditional Definitions of Loans ('Cash Advances,' 'Lease Cash') at Interest Rates of Over 700% APR. Credit Card Finance Charges of 19.9% APR are a Bargain in Comparison to these Usurious Interest Rates.

[7] More Than One-Half of US Credit Card Debt is Re-Sold as "Securitarized" Bonds (NY, London, Tokyo). This Means Institutional Investors are Purchasing Credit Card Debts to Help Finance Your Future Retirement.

[8] A 1997 Marketing Campaign by the US Department of Treasury encouraged the Purchase of "Savings Bonds" Over the Internet With Bank Credit Cards; Credit Card Interest Rates Averaged About 18% versus 4.5% for Bonds.

[9] Banks Routinely Reject Credit Card Applications From Senior Citizens While Inundating Their Grandchildren With Offers--Before Their First Job--in College.

[10] Over Educated and Under Compensated Recent College Graduates Often Refer to Their Credit Cards as a Form of Social Class Entitlement: "YUPPIE FOOD STAMPS."

Appendix B

Six Months of Financial Freedom: Can You Afford It?

Ann saw the promotional offer in the weekend edition of the *Orlando Sentinel* newspaper and thought that it sounded almost too good to be true. A Home Depot credit card with a promise of 10% off the first purchase (up to $2000) and zero percent financing and NO PAYMENTS for six months. She called the Home Depot credit approval office—toll free—and received a $1,000 line of instant credit, courtesy of the new "partnership" with Citibank's private issue credit card subsidiary. Ann thought that with the backsliding of the economy, it was a great opportunity to finally replace the 20 year-old carpet in her home. Although Ann's local Home Depot store in suburban Orlando, Florida refused to honor the discount coupon, the final sale price of $1,619 with free padding for wall-to-wall carpeting in her two-bedroom house was too good to pass-up.

After a call to the credit department, which was informed of Ann's pending purchase by a sales agent, her Home Depot credit card limit was raised to a $10,000. Hard to believe considering that her current monthly income of about $1200 was dwarfed by the over $21,000 in outstanding credit card balances on her six other credit cards. Ann was surprised and relieved that the exaggerated income that she listed on the application was not checked (she reported $2500 per month).

To Ann, six months without payments seemed like an eternity and interest free, too. She couldn't wait to feel the plush new carpet under her bare feet. When the first bill arrived, she did not realize that the free financing clock started ticking on the date of the sale contract NOT the day of installation. So instead of six months of no payments it was really only five months. When the second bill arrived, Ann did not understand why there was a monthly finance charge of $20.88 and simply reminded herself that it was interest free. Afterall, the Home Depot salesman assured her that there were no finance charges on the purchase. And, everyone was complimenting her on how nice the new carpet looked.

It was only after six months had passed that Ann understood the financial realities of the "promotional offer." The accrued interest charges of $125 was now added to the $1,619 sale price at an annual percentage finance rate (APR) of 15.48 percent. With a minimum monthly payment of $25, it was manageable but will require 15 years to pay it off assuming no additional charges. And, the conveniently low minimum payment obscured the total cost of the carpet at the end of the 15 year period--$4,489. Needless to say, no one mentioned that increasing the monthly payment by only $10 would cut the payoff period in half to only 7 ½ years and thus reduce the final cost to "only" $2,811. Or, that lowering the APR by only 3 percentage points (12.48%) would reduce the payoff period to 10 ½ years and the total cost to $3,124.

Ann was interviewed for this article in March 2003 and requested that her last name not be identified.

Selected References

Ausubel, Lawrence. 1991. "The Failure of Competition in the Credit Card Market." *American Economic Review,* March:50-81.

Calder, Lendol. 1999. *Financing the American Dream: A Cultural History of Consumer Credit.* Princeton: Princeton University Press.

Canner, Glenn B. and Charles A. Luckett. 1999. "Payment of Household Debts," *Federal Reserve Bulletin*, April, pp. 218-229.

Card Industry Directory 2003 Edition. 2002. Thompson Publishers.

Caskey, John P. 1994. *Fringe Banking: Check Cashing Outlets, Pawnshops, and the Poor.* New York, Russell Sage.

Consumer Federation of America (CFA). 2002. "Credit Card Issuers Expand Marketing and Available Credit, Consumers Increasingly Say No." Washington, D.C., Consumer Federation of America.

Daly, James J. 2002. "A Little Help From Uncle Sam, Government Intervention Never Looked Better Than It Did in 2001." *Credit Card Management,* March, pp. 3-7.

Draut, Tamara. 2003. *Trying to Make Ends Meet: The Growth of Credit Card Debt.* New York: Demos Final Report.

Drentea, Patrica. 2000. "Age, Debt and Anxiety." *Journal of Health and Social Behavior* 41:437-450.

Drentea, Patrica and Paul J. Lavrakas. . 2000. "Over the limit: the association among health, race and debt." *Social Science & Medicine* 50:517-529.

Durkin, Thomas A. 2000. "Credit Cards: Use and Consumer Attitudes, 1970-2000." *U.S. Federal Reserve,* September, pp. 623-634.

Dymski, Gary A. 1999. *The Bank Merger Wave: The Economic Causes and Social Consequences of Financial Consolidation.* New York: M.E. Sharpe.

Glasberg, Davita Silfen and Dan Skidmore. 1997. *Bank Deregulation and the Savings and Loan Bailout.* New York: Aldine de Gruyter.

Lazarony, Lucy. 2002. "Watch out: $35 late fees on credit cards" Bankrate.com.

Macey, Jonathan R. and Geoffrey P. Miller. 1997. *Banking Law and Regulation.* New York: Aspen Publishers.

Nellie Mae. 2002. *Undergraduate Students and Credit Cards.* Boston: Nellie Mae.

Mandell, Lewis. 1990. *The Credit Card Industry: A History.* Boston: Twayne Publishers.

___________. 1998, 2000, 2002. *Our Vulnerable Youth: The Financial Literacy of American 12th Graders: A Failure by Any Measure.* Washington, D.C.: JumpStart Coalition for Personal Financial Literacy.

Manning, Robert D. 1999. *Credit Cards on Campus, The Social Consequences of Student Debt.* Washington, D.C.: Consumer Federation of America.

______________. 2000. *Credit Card Nation, The Consequences of America's Addiction to Credit.* New York: Basic Books.

______________. 2002. *"Credit Cards on Campus: A Growing Collegiate Crisis or Benign Societal Trend?"* Testimony before the U.S. Senate Banking, Housing, and Urban Affairs Committee, Washington, D.C.

______________. 2003a. "Predatory Plastic." Special issue of *Southern Exposure Magazine,* "Banking on Misery," edited by Michael Hudson

______________. 2003b. "Aging Into Debt." In *Encyclopedia of Financial Gerontology*, edited by L Vitt and J. Siegenthaler. Westport, Conn: Greenwood Press, forthcoming.

______________. 2004. *Give Yourself Credit.* San Francisco: Alta Mira Press, forthcoming.

Nocera, Joseph. 1994. *A Piece of the Action: How the Middle Class Joined the Money Class.* New York: Simon & Shuster.

Pinto, Mary Beth, Diane H. Parente, and Todd S. Palmer. 2000. "College Students' Credit Card Debt and the Role of Parental Involvement: Implications for Public Policy," *Journal for Public Policy and Marketing*, 20 (1):105-113.

Punch, Linda. 2003. "Fading Pay," *Credit Card Management,* June, p. 42.

Schor, Juliet B. 1998. *The Overspent American: Upscaling, Downshifting, and the New Consumer.* New York: Harper Collins.

Staten, Michael E. and John M. Barron. 2002. "College Students and Credit Cards," Credit Research Center, Georgetown University, unpublished report.

Sullivan, Teresa A., Elizabeth Warren, and Jay L. Westbrook. 2000. *The Fragile Middle Class: Americans in Debt.* New Haven: Yale University Press.

Tucker, David M. 1991. *The Decline of Thrift in America: Our Cultural Shift from Saving to Spending.* New York: Praeger.

U.S. Department of Education. 2002. *Student Financing of Undergraduate Education: 1999-2000.* Washington, D.C.: National Center for Educational Statistics.

U.S. Federal Deposit Insurance Corporation. 2003. "Quarterly Banking Profile, First Quarter 20003." Washington, D.C.

U.S. Federal Reserve Board. 2002. "The Profitability of Credit Operations in Federal Depository Institutions." Washington, D.C., June.

U.S. House of Representatives, Subcommittee on Financial Institutions and Consumer Credit. 2001. Hearing on "Abusive Credit Card Industry Practices," November 1.

Warren, Elizabeth. 2002. "The Market for Data: The Changing Role of Social Sciences in Shaping the Law." *Wisconsin Law Review*: 1-43.

Weber, Joesph. 2003. "Plastic That Looks Like Gold," *Business Week*, June 16, p. 70.

David Moskowitz

General Counsel, Wells Fargo Home Mortgage

Wells Fargo & Co

Testimony

Before the

Subcommittee on Financial Institutions and Consumer Credit

A hearing entitled
"The Role of FCRA in the Credit Granting Process"

June 12, 2003

My name is David Moskowitz and I am the General Counsel for Wells Fargo Home Mortgage, headquartered in Des Moines, Iowa. Wells Fargo, our parent company, is a diversified financial services company, offering mortgage, securities, insurance, real estate services, online banking, institutional and retail banking products under the Wells Fargo brand through a number of separately incorporated affiliates to 15 million customers nationwide. Wells Fargo's headquarters is in San Francisco; the company has 130,000 employees, has mortgage offices nationwide, and has a retail banking presence in 23 states.

Thank you for the invitation to testify. I would like to share with you some of Wells Fargo Mortgage's experiences in providing products and services within the framework established by the Fair Credit Reporting Act.

Wells Fargo Home Mortgage works in concert with its other Wells Fargo business affiliates in providing financial services products to customers. Marketplace experience shows that consumers expect the financial services companies they do business with to know about their accounts, to respond quickly to their questions and to advise them about products and services that will help them reach their financial goals. The service consumers expect requires that Wells Fargo have integrated information systems to give customers what they want -- when, where and how they want it. Subject to the Fair Credit Reporting Act, Wells Fargo shares customer information internally to meet these goals.

Information Integration by Affiliates in the Same Corporate Family

Providing a new mortgage, refinancing an existing mortgage, meeting our contractual servicing requirements for investors and our customers requires information about their financial affairs. Applying inappropriate restrictions on transfers of information among affiliates would impede customer service.

The 1996 amendments to the Fair Credit Reporting Act recognize the value to customers of the ability to transfer information among affiliates. This ability is wholly consistent with consumer expectations that their questions will be answered and their needs will be met with a single call or a single e-mail message, whether their financial products are provided by a single company or several companies in the same affiliated group. To put it another way, customers do not care whether for technical, regulatory, or management reasons Wells Fargo chooses to organize itself into a particular series of affiliates of a holding company or subsidiaries of one bank. What customers do care about is the seamless delivery of the products Wells Fargo offers regardless of how we choose to distribute them.

In Wells Fargo's view it is consumer expectations and needs that should shape the public policy that regulates information use, not legal structure. Because of legal requirements that prohibited or restricted bank branching, Wells Fargo at one time owned numerous separately incorporated banks. The Riegle-Neal Act of 1994 allowed bank holding companies to consolidate banks into as few as a single charter. Today, for business reasons rather than legal reasons, Wells Fargo owns 28 separately chartered banks. But the number of separate banks that a holding company chooses to have should not affect public policy relating to information use. If a bank holding company conducts its banking business in a single bank entity that bank would have all the information about a customer who had deposits, a mortgage, a credit card and a home equity loan from that bank. As a single corporate entity, it could use this information without restriction to serve its customer.

If, on the other hand, the bank holding company chose to conduct its mortgage, credit card and home equity loan businesses in three separately incorporated banks and the law restricted the sharing of information among affiliates, a customer who supplied the same information for the same products to three affiliated institutions instead of a single institution would not receive the same level of service from its financial services company. To use customer information to provide the same level of service that could be provided by a single entity with the same information about the same customer, a holding company like Wells Fargo that provides services through multiple bank and non-bank charters would have to consolidate its operations into as few charters as legally possible. Because of the uncertainties of the outcome of the FCRA debate, institutions like Wells Fargo will likely change their corporate structures to reduce the number of separate entities rather than risk restrictions on information sharing among affiliates. It is our view the corporate structure should not be a factor in setting public policy regarding information use. The touchstone, instead, should be consumer expectation.

This is especially critical to our mortgage business. Since passage of the 1996 amendments to the Fair Credit Reporting Act, mortgage servicing has become more efficient. Wells Fargo customers have more channels through which they can apply for a mortgage and get assistance or conduct transactions related to a mortgage, as well as the complete array of financial products offered by Wells Fargo. With affiliate transfers and use of customer information, mortgage customers can make a mortgage payment at their local bank branch, obtain balances, get consolidated statements and get the support of 24-hour call centers that serve an entire affiliated enterprise.

Information Integration within the Corporate Family Benefits Consumers

It is Wells Fargo's goal to provide seamless service and product advice to its customers no matter which member of the Wells Fargo family of companies provides the particular product or service. With the FCRA framework, companies can do a better job of evaluating credit and market risk. This translates into better and lower cost services to customers. Wells Fargo can offer a variety of mortgage services and products, such as:

- **Quick turnaround on refinancings**. Wells Fargo Home Mortgage can quickly gather needed data from all Wells Fargo businesses with which the customer may have a relationship – either to refinance an existing Wells Fargo Mortgage or provide a new Wells Fargo mortgage to a customer of other Wells Fargo businesses. This facilitates a quick refinancing and often at lower cost.

- **Discount on closing costs for signing up with Wells Fargo's product line:** Wells Fargo Home Mortgage retail offices offer new mortgage customers a $300 discount on closing costs if the customer starts a package relationship with Wells Fargo Bank. The package would provide the customer with a bank account, a credit card, discounts on brokerage fees/Wells Trade and a free consultation with a financial consultant The benefit to a customer is an opportunity to have basic financial needs met by one financial services provider at a price that reflects the value of the overall relationship.

- **Referrals lead to new homeowners**. In California, 40-50% of Wells Fargo's mortgages originated this year are the result of referrals from Wells Fargo Banks to Wells Fargo Home Mortgage. Many are first-time homebuyers in Hispanic market areas. These referrals could not be accomplished without the ability to share information among affiliates.

- **Alternative financing options for customer**: a homebuilder in Oklahoma City, who is a customer of Wells Fargo Home Mortgage, wanted to take advantage of lower interest rates and re-finance his motor home. The Wells Fargo mortgage store in Oklahoma City could not help him, as it only provides financing for 1-4 family residential properties. However, by sharing the customer's financing question with the Wells Fargo Bank in Wichita Falls, TX (140 miles away), the Wichita Falls bank provided bank financing on the motor home, saving the customer hundreds of dollars a month in interest payments.

Actions by multiple states to enact their own state versions of the Fair Credit Reporting Act will frustrate customers that do routine transactions across state lines. Wells Fargo provides services to thousands of customers that may have accounts "domiciled" in one state, yet reside or do business with a Wells Fargo bank in another state. Nearly half a million Wells Fargo customers have made teller or ATM transactions out of state within the past 5 months. In California, of 3 million accounts, over 100,000 transact business at a Wells Fargo bank in a state other than where their account resides. In Texas, of 1 million accounts, 36,000 transact business in a border state. In Minnesota, of 750,000 accounts, 25,000 do business in a Wells Fargo bank in a neighboring state.

__Uniform National Standard__

Finally, Wells Fargo believes the current uniform national standard for information use, as provided by the 1996 amendments to the FCRA is vital and asks that this Congress provide clarity and stability by removing the sunset provisions that affect affiliate sharing and other segments of credit granting. Congress should also address identity theft and should grant authority to bank regulators to set new national standards for notices about information use to customers. The problem of identity theft and complicated notices about information use are frustrating to both customers and financial service providers.

The availability of financial services, such as mortgages for our customers, and the flows of information required to make those services available do not stop at state borders or corporate structures.

Thank you and I would be happy to answer any questions that you, Chairman Bachus, or the Subcommittee may have.

National Association of Mortgage Brokers

Prepared Testimony

National Association of Mortgage Brokers

on

The Fair Credit Reporting Act

before the

House Financial Services Committee

Subcommittee on Financial Institutions and Consumer Credit

Thursday, May 12, 2003

Chairman Bachus, Ranking Member Sanders, and members of the Committee, I am A.W. Pickel, President-Elect of the National Association of Mortgage Brokers (NAMB) and President of Leader Mortgage Company in Lenexa, Kansas. I appreciate the opportunity to present NAMB's views on the Fair Credit Reporting Act (FCRA). NAMB is the nation's largest organization exclusively representing the interests of the mortgage brokerage industry and has more than 14,000 members. NAMB represents mortgage brokers in all 50 states as well as the District of Columbia. NAMB provides education, certification, industry representation, and publications for the mortgage broker industry. NAMB members subscribe to a strict code of ethics and a set of best business practices that promote integrity, confidentiality, and above all, the highest levels of professional service to the consumer.

Today, mortgage brokers originate more than 60% of all residential mortgages. They are vital members of their communities, often operating in areas where traditional mortgage lenders do not, such as rural communities. A mortgage broker is an independent real estate financing professional who specializes in the origination of residential and/or commercial mortgages. A mortgage broker is also an independent contractor who markets and originates loans offered by multiple wholesale lenders.

I want to commend this Committee for holding a series of hearings on an issue that is vital to our economy and to consumers. FCRA provides a national standard for credit reporting and allows intrastate and interstate commerce to flourish. A national uniform credit reporting system impacts nearly every business sector that makes consumer credit related decisions. More importantly, this system impacts a consumer's ability to access reasonably priced credit. It is also essential to the operation of the mortgage industry. The information that is provided by consumer reporting agencies is required to make sound mortgage lending decisions and to help evaluate risk. In addition, the information obtained by mortgage originators is essential to provide consumers with the access to reasonably priced products.

I. Background on FCRA

Over thirty years ago, Congress created a national framework that has developed the most efficient and reliable credit reporting system in the world. The primary purpose of FCRA is to ensure "confidentiality, accuracy, relevancy, and proper utilization."[1] Through FCRA, Congress developed a system whereby a balance was struck that encourages the voluntary reporting of consumer information while maintaining accuracy of the information reported. The reliability of credit bureau data through the national uniform standard created through FCRA has facilitated significant changes to our marketplace to the benefit of consumers and businesses. For example, a business in New Jersey can do business with a consumer located in Alabama based on the reliability of information provided by credit bureaus. FCRA creates a uniform national credit system that goes beyond state borders.

As the Federal Trade Commission and the Federal Reserve Board have testified, the development of consumer credit came after the World War II era, when this country's financial system became much too large and complex to transfer credit information about consumers. It was no longer feasible to evaluate consumer credit at the local level. Personal relationships between consumers, merchants and banks became less localized as the nation's population increased and consumers became more mobile. Consumer credit also was in high demand as the nation moved away from the "cash only" era, and consumers sought goods and services on demand through credit. In addition, there was an increase in demand for home ownership. All of these factors and other factors resulted in the creation of a national uniform credit system. Consumers and the industry alike, will agree that the current national credit system has had, as Chairman Greenspan states, "a dramatic impact...on consumers and households and their access to credit in this country at reasonable rates."[2]

In 1996, Congress amended FCRA to expand the permissible uses of credit report data, further encourage the accuracy of reported information, in addition to giving consumers more authority and oversight to their credit information. One of the most critical components of FCRA, created by the 1996 amendments, was to preserve and enhance the uniformity of the national reporting system by creating Federal preemption of state and local laws.[3]

---

[1] Fair Credit Reporting Act of 1970, Pub. L. No. 91-508, 84 Stat. 1114 (codified at 15 U.S.C. §§ 1681-1681t).
[2] Remarks following prepared testimony by Chairman Alan Greenspan, Board of Governors of the Federal Reserve System, February 12, 2003, House Financial Services Committee.
[3] 15 U.S.C. § 1681t(a)(b).

The broad Federal preemption provision states that no requirement or prohibition may be imposed under the laws of any state with regard to matters specifically identified as being a preemption provision.[4] The preemption standard applies to seven specific areas, many of which play an integral part of our current uniform credit system. This broad preemption provision expires on January 1, 2004.

If Congress does not amend FCRA to extend the preemption provision, states are free to enact different laws on the specific matters addressed in FCRA, which could severely jeopardize our current national uniform credit system.

II. Support for the Current National Uniform Credit System

If Congress allows the preemption provisions in FCRA to expire, the outcome of such inaction will have a detrimental effect on a consumer's access to and availability of credit. NAMB generally supports the extension of the preemption provisions, some of which I will address. NAMB believes that failure to extend the preemption provisions will increase risks for mortgage originators, which could have a significant impact on the cost and availability of credit for housing. . Further, it will lead to the imposition of new operational costs on the industry, which will result in an increase in the cost of credit for consumers and a reduction in the access to credit for consumers. As such, NAMB believes it is important that the federal preemption provisions of FCRA be extended so that our current national credit system remains fluid, workable and continues to provide consumers with strong benefits and protections.

FCRA provides uniform national standards that have increased the effectiveness of consumer report information that plays a fundamental role in the mortgage origination process. A mortgage broker's ability to obtain information about a consumer's credit is as essential to their business as is the ability to transfer that information across state lines for the benefit of the consumer. Permitting states to enact inconsistent credit system laws will disrupt the current free flow of information that enhances interstate commerce. If laws vary from state to state, it will be very difficult to maintain a practical and reliable credit system that promotes efficiency in the marketplace that consumers currently enjoy. Failure to continue our current national uniform system will have a sweeping impact on every sector of the economy, from consumers to retailers to employers. It could also have a detrimental impact on this country's housing market - one of the only markets sustaining this economy.

The ability to make quick decisions on offers of credit is critical to both consumers and mortgage originators. The expedited flow of information enables credit grantors to make immediate and accurate credit decisions. Consumers greatly benefit from the expeditious manner in which credit decisions are made and enjoy the convenience of the current process. Applying for a mortgage was a very time-consuming process before the carefully constructed balance of FCRA was created. Processing a mortgage application required personal contacts with references, other creditors, and contacts with individuals

[4] 15 U.S.C. § 1681 (b).

who had knowledge of a consumer's personal financial history. The process to obtain credit, was lengthy, as loan officers would have to go through a comprehensive procedure with consumers to verify consumer credit.

In a post-FCRA (as amended) world, consumers can obtain access to credit virtually instantaneously on a wide array of credit products. In addition, consumers can even shop for competitive rates through the Internet and pursue a mortgage from a lender or a mortgage broker that is located in a different state.

The current national uniform system also promotes competition throughout the industry. As a result of competition, consumers are presented with more opportunities and choices in obtaining a mortgage. This competition enables mortgage brokers to do what they do best – place consumers in homes. As such, homeownership has increased over the years, especially among minorities.

These consumer benefits would cease to exist if the preemption provisions contained in FCRA are not extended. States could enact legislation on seven subject areas, which would create a patchwork of state laws for credit grantors to comply with, making it difficult if not impossible for consumers to obtain expeditious and cost effective access to credit. Permitting states to enact inconsistent laws could also prevent consumers from reaping the true competitive benefits of the current national uniform credit system.

III. Expiring Preemption Provisions

Consumer Report Contents

This preemption provision prohibits states from regulating the information that may be included in consumer reports. If this preemption provision expires, states could preclude consumer-reporting agencies from including certain information about consumers in consumer reports and impose time limitations during which such information could be included.

Further, the information contained in the consumer reports could vary from state to state thereby reducing the reliability of the reports and negatively impacting the scoring model used to determine mortgage rates. For example, a consumer report in one state may not include the same information, causing the report not to have the same significance as a consumer report in another state. One state may require that consumer reports include bankruptcy information whereas a consumer report in another state may not require such information to be reported thereby not reflecting a consumer's true credit history.

If states enact inconsistent state laws on what information can be contained in a consumer report, some consumers may not receive credit although they qualify and some consumers that do not qualify may receive credit thereby eliminating the reliability of our current credit system. Such inconsistent state laws would result in a gap in our current credit system, and consumers could suffer the consequences of such a gap.

It is critical to the continued availability of consumer credit at reasonable costs that mortgage brokers have the ability to obtain standardized consumer reports that contain nationally uniform full factual credit information. The information contained in a consumer report is an essential component to the mortgage process. What is contained in a consumer report dictates the terms and rates for a consumer's mortgage. A national uniform standard for the information contained in a consumer report is crucial since credit grantors rely on consistent information about consumers that can be used to make credit decisions.

Without full and complete accuracy of information delivered in a uniform manner, the technological advances that have been made in real estate finance lending over the last eight years would not be possible. Sophisticated predictive models have been designed to assess risk, as reflected in a consumer's credit score. Scoring models are based on an analysis of historical consumer data, which allow creditors to develop systems that help them to better predict the risk of default by a particular consumer.

Accurate reports benefit not only the consumer, but the mortgage broker and lender who are able to make more rapid and accurate credit decisions utilizing these scoring models within their underwriting. Risk assessment based on a borrower's past payment history, replaces the old face-to-face attempts to evaluate character and capability to repay which was so common many years ago.

The lack of a national standard on the contents of a consumer report would add a level of uncertainty in the risk profile of a consumer's credit history, thereby eliminating the ability to ascertain credit risk when pricing a mortgage. As a result, the price of credit will increase, and access to credit will be reduced, which could result in a reduction in this country's historically high homeownership rates.

Adverse Action Notices

This preemption provision prohibits states from regulating the duties of persons to provide adverse action notices to consumers in connection with the use of consumer reports. If this preemption provision expires, states could enact legislation to require users of consumer reports to provide additional information on the adverse action notice and enforce specified time limitations and circumstances under which the notices are provided. Under some circumstances, mortgage brokers provide adverse action notices when a consumer is declined credit or a credit product by either them or their wholesale lender or when a consumer qualifies for a different product based on a consumer's credit.

If a company transacts business in multiple states, they would have to send a different adverse action notice depending on particular state law requirements. If the content of the adverse action notice and circumstances under which the notice is provided varies from each state, businesses will experience a significant increase in operational costs. Unfortunately, these operational costs will be passed through to consumers in the form of higher credit costs.

Furnishers of Information
This preemption provision prohibits a state from regulating the responsibilities of persons who furnish information to consumer reporting agencies. If it expires, states could enact laws imposing different obligations on furnishers. States could create laws relating to those who furnish information to credit bureaus and impose varying duties on furnishers to correct and update information reported. States could also create laws imposing liability for failure to comply with certain furnisher obligations. They could also impose a duty on the furnisher to investigate consumer claims reported to credit bureaus.

States may impose duties on furnishers that are impractical for furnishers to comply with, which will result in an increase in compliance cost. Mortgage brokers generally do not furnish information to consumer reporting agencies. However, the lenders with which mortgage brokers transact business and many other industry sectors do furnish information to consumer reporting agencies.

If furnishers decide that compliance with different state laws is too burdensome, furnishers may choose not to submit the information at all thereby making consumer reports inaccurate or unreliable. This will result in a reduction in credit for the consumer and will increase the cost of credit since the risk of not knowing the credit worthiness of an individual will have to be priced as such.

Procedures of Disputing Inaccurate Information
This preemption provision applies to the procedures a consumer reporting agency must use if a consumer disputes the accuracy of information in his/her consumer report. If this preemption provision expires, states could enact varying procedures for consumer-reporting agencies to follow when they dispute information contained in their consumer report. This could result in a patchwork of state laws that impose different investigation duties on consumer reporting agencies, including the amount of time required to investigate a consumer dispute.

Some states may allow a consumer reporting agency a longer period of time to investigate disputed reports whereas other states may allow a shorter period of time to investigate. This could lead to a cursory and inaccurate investigation to the detriment of consumers. Mortgage brokers often work with consumers to help them to review and correctly dispute their credit when necessary to effect the most rapid modifications necessary before a consumer applies for a mortgage loan. It is one of the many benefits consumers experience when they work with a mortgage broker. Cursory and inaccurate investigations of credit disputes will frustrate this working relationship between a mortgage broker and the consumer.

Mortgage brokers have continued to work with the Consumer Data Industry Association (CDIA) in an effort to correct the dispute resolution issues we find on a daily basis on behalf of consumers. Mortgage brokers have played an active role notifying and encouraging repositories to continually better the accuracy in credit reporting. Mortgage brokers have been the watchdogs who have given CDIA the examples of the problematic reporting we have had to help consumers overcome in securing their home financing.

Inconsistent state procedures relative to disputing inaccurate information will upset the ability of mortgage brokers to continue to work with consumers on fixing their credit inaccuracies.

If states enact different laws on the procedures of disputing inaccurate information, consumers may receive a fair and comprehensive investigation solely contingent upon the state in which credit was extended. The process whereby a consumer disputes information contained in their consumer report would therefore result in an inequitable and unreliable process.

Affiliate Sharing

This preemption provision prohibits states from regulating the exchange of information among affiliates. As the financial services sector has evolved, financial services companies have come to rely a great deal on sharing information among affiliates. Although many of these companies are structured through separate legal entities, they serve their customers through one unit.

The ability to share among affiliates allows a company to tailor products and services to individual consumers thereby increasing consumer choice and reducing costs. Pursuant to FCRA, information can be shared among affiliates with limited restrictions. Information can be shared among affiliates without restriction if the information relates generally to experience and identification information. Affiliates can also share nonexperience information provided that the consumer has been notified that the information may be shared and is given an opportunity to opt out of sharing their information.

Generally, most mortgage broker businesses are very small, with very few employees, so most mortgage brokers do not have affiliates with which they share consumer information. However, some mortgage brokers do have business affiliates, such as a title company or appraisal company affiliates that consumers may work with throughout his or her purchase of a home. Some mortgage brokers also have insurance and financial planner affiliates. However, as the mortgage marketplace continues to grow and evolve, this could certainly be an issue in the future for mortgage brokers.

If this preemption provision expires, our national uniform credit reporting system could dwindle as states enact different affiliate sharing standards. The operational costs for companies would increase as they attempt to comply with inconsistent state affiliate sharing requirements. Any costs associated with such compliance will ultimately be passed on to consumers. If states impose restrictions on affiliate sharing, great benefits currently enjoyed by affiliate sharing, such as cross-marketing products and obtaining certain affiliate services, will be missed. The current national uniform affiliate-sharing standard is critical to the operational infrastructure of companies and provides enhanced benefits to consumers.

Identity Theft
In the context of FCRA, Congress has been focusing on the issues relative to identity theft. NAMB supports efforts to address the growing problem of identity theft, but is concerned about that these efforts could be at the expense of the consumer. Identity theft is one of the fastest growing crimes in this country. Identity theft can tarnish a consumer's credit and sabotage their ability to obtain credit. NAMB believes that enforcement is also an integral component to combating identify theft.

Mortgage brokers today are constantly educating their consumers about methods to safeguard their credit. Mortgage brokers are generally the first contact for a consumer who must give that consumer the bad news about credit information revealed on his or her report that indicates someone else is using his or her identity. Mortgage brokers often spend hours assisting the consumer in how to clear their credit records before that consumer is in a position to make an application for a real estate loan. Mortgage brokers have a strong interest in eliminating avenues for identity theft.

We look forward to working with Congress and the Administration to address the growing concern with identity theft.

Conclusion
The benefits of FCRA expand to a broad range of industry sectors from the mortgage originator to the retailer. These benefits are derived from an accurate, reliable and national uniform credit reporting system. FCRA provides a very carefully balanced uniform system that allows for the continued flow of consumer information. If the preemption provisions in FCRA are allowed to expire, our national uniform credit reporting system will be endangered and the benefits from FCRA will be lost.

Thank you for giving NAMB the opportunity to testify today on this very important issue.

Consumer Federation of America

TESTIMONY OF

TRAVIS B. PLUNKETT
LEGISLATIVE DIRECTOR

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT OF THE HOUSE COMMITTEE ON FINANCIAL SERVICES

REGARDING

THE ROLE OF THE FAIR CREDIT REPORTING ACT IN THE CREDIT GRANTING PROCESS

JUNE 12, 2003

Good morning Chairman Bachus, Ranking Member Sanders and all the members of this subcommittee. My name is Travis B. Plunkett and I am legislative director of the Consumer Federation of America.[1] I appreciate the opportunity to offer our comments on role of the Fair Credit Reporting Act in the credit granting process. This is a broad and important topic for consumers. For many years, CFA has conducted research and offered public policy recommendations on many aspects of this issue, including the extension and marketing of credit cards and the accuracy of credit reporting data. As this panel has been asked to focus on FCRA and mortgage lending, I will largely confine my remarks to this topic.

As this subcommittee has heard, the credit reporting system in the United States has experienced significant technological change in recent years. The good news is that consumers have benefited from many of these developments. Credit decisions can be made faster than ever before. As new tools for credit risk assessment have been developed – and creditors have generated substantial profits by charging higher fees and interest rates for riskier loans -- credit has been extended to many worthy consumers who in the past might not have been eligible. Partly as a result of this development, homeownership in this country has grown.

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]. More recent estimates from industry leader Fair Isaac indicate that 75 percent of mortgage lenders and over 90 percent of credit card lenders use its credit scores in making credit decisions[3].

However, there is bad news too. Some lenders extended credit to subprime borrowers in an abusive and predatory manner, abusing their new technological capabilities to develop usuriously high interest rates and fees carefully targeted at unwitting and vulnerable consumers. These lending practices contributed to an unprecedented growth in bad credit card and mortgage debt, home foreclosures and personal bankruptcies in recent years. Meanwhile, as subprime lending boomed, the Fair Credit Reporting Act's protections to ensure reporting accuracy, protect consumer privacy and prevent identity theft have not kept pace. The increased speed with which credit decisions are now made exposes a significant number of consumers to new problems and abuses for which old safety measures are inadequate. It is as if the credit reporting industry has developed a BMW engine that powers an old Model T car without seat belts, air bags and other modern safety features.

In short, the Fair Credit Reporting Act (FCRA) is in need of an overhaul. This is especially true because this nation's policy is to continue to increase home ownership, particularly among minorities. There is a direct connection between the accuracy and completeness of credit information that is used about these potential borrowers and whether they

---

[1] CFA is a nonprofit association of 300 pro-consumer organizations that, since 1968, has sought to advance the consumer interest through education and advocacy.

[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] National Consumer Law Center. Fair Credit Reporting, 2002. Page 349.

have access to mortgage loans at affordable and sustainable rates. We have a special societal obligation to ensure that mortgage lending to this potential pool of homeowners is granted fairly.

I. Broad and Credible Evidence Demonstrates Serious Problems with Credit Reporting Accuracy

A fair and economically viable credit reporting system requires accurate information. Congress has recognized the importance of accuracy in the FCRA. Multiple witnesses who have already testified before this subcommittee have indicated that accuracy is a major concern. The inclusion of accurate and complete information in consumer credit reports benefits consumers, creditors, and score developers. Consumers are in a better position because they are more likely to be judged based on the actual risk they pose to a potential lender. Creditors benefit because they have a more accurate understanding of the risk posed by consumers and can better compete against other lenders. And companies that develop decision tools such as credit scores can make those scores more accurate if they have more accurate information with which to develop their models.

Of all of the witnesses who have come before this committee, none have articulated what is at stake more concisely than Howard Beales, the Director of the Bureau of Consumer Protection at the Federal Trade Commission when he stated, "... credit report accuracy was, and remains, a core goal of the FCRA. Because even small differences in a consumer's credit score can influence the cost or other terms of the credit offer, or even make the difference between getting approved or denied, accuracy of the information underlying the score calculation is paramount." Unfortunately, a broad range of evidence provided by a variety of sources shows that inaccurate and incomplete reporting is a persistent, significant problem.

A. Consumer Federation of America and National Credit Reporting Association Study finds dramatic discrepancies in credit scores and underlying credit information among credit repositories.

1. Credit score variations are very costly to consumers.

In December 2002, the Consumer Federation of America and the National Credit Reporting Association released an exhaustive study of the accuracy of credit scores and the credit report information that serves as the foundation for those scores.[4] Researchers reviewed credit report information for a randomly selected sample of more than half a million actual consumers (502,623) seeking mortgage credit. Using a layered methodology, CFA and NCRA examined three sample groups in increasing detail to assess the impact and likely causes of the dramatic discrepancies found in this study. The findings for all three groups were consistent, including the typical discrepancies in scores, the frequency of discrepancies of various magnitudes and the major explanations offered by lenders for the calculation of creditworthiness. To quantify the potential impact of these variations on consumers in the mortgage market,

[4] Consumer Federation of America and National Credit Reporting Association. *Credit Score Accuracy and Implications for Consumers*. December 2002. Available at: http://www.consumerfed.org/121702CFA_NCRA_Credit_Score_Report_Final.pdf

researchers closely examined the files of consumers with credit scores near 620, the widely recognized standard in the industry separating prime and subprime mortgage candidates.

The study found wide variations in the credit scores for a given consumer among the three national credit repositories (Experian, Equifax, and Transunion). The average discrepancy for all consumers was 41 points, but credit scores for nearly one in three consumers varied by 50 points or more, and credit scores for one in 25 consumers varied by 100 points or more.[5]

The study found that approximately 20 percent of all consumers – about 40 million Americans – are at risk for misclassification into the subprime mortgage market because their scores are near the 620 pricing cutoff point and vary significantly. Consumers above this pricing point receive prime loans with more favorable terms and rates, while consumers with scores below it receive less favorable terms and higher interest rates. Roughly eight million consumers – one in five of those who are at risk – are likely to be misclassified as sub-prime upon applying for a mortgage, based on the study's review of credit files for errors and inconsistencies. A similar number of consumers are likely to benefit from errors in their reports. However, individual consumers do not benefit from system-wide averages and should not have to cope with a credit reporting system that functions as a lottery

Falling below the cutoff score for a prime rate mortgage can place a tremendous financial burden on these 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[6], 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[7].

While these findings are extremely troubling, they actually underestimate the overall impact of inaccuracies on consumers in the mortgage market. The CFA study considered a single pricing point, 620, and the impact of one dimension of a single transaction, interest paid on mortgages. In the purchase of a home, credit scores play a major role in determining the availability and cost of homeowners insurance, mortgage insurance (for those with down payments of less than 20 percent of the loan) and of utilities and phone service.

In addition, pricing points are proliferating for many financial services products, putting more consumers in harms way. Currently a small discrepancy may not have any impact on consumers with higher credit scores, for example in the mid to high 700's. But increasingly, lenders have a desire to more finely differentiate among consumer classes by creating ever more

---

[5] Score discrepancies reflect differences in the underlying credit data collected by each agency, not differences in the scoring software they use. All three credit reporting agencies buy virtually the same software from Fair, Isaac, and Co. Furthermore, the study determined that score variations could not be attributed to a lag in the adoption of new generations of this software.
[6] 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.
[7] 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.

pricing points. Building such a system without data that is precise and accurate enough to support these pricing distinctions will put more and more consumers into the credit lottery.

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

The study found that approximately seven in ten credit reports indicated that the primary factor contributing to the score was "serious delinquency," "derogatory public record," or "collection filed," or some combination of these factors, without providing any information about which specific accounts were responsible for the lowered scores. In many cases, it was not even possible to determine which of these extremely broad explanations -- 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 available revolving credit limits was too high. These two relatively generic categories of explanations were reported as the primary reason for a derogatory score on a total of more than seven in ten 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 credit activity that may fall under the broad terminology "serious delinquency, derogatory public record, or collection filed." 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 these 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 the 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.

3. Consumers are harmed by errors of commission and errors of omission.

A detailed analysis of the types of credit reporting errors that occurred revealed that errors of omission (non-reporting of information) and errors of commission (incorrect or inconsistent data included in the report) both occurred at significant levels. [8]

- Nearly eight in ten files (78 percent) were missing a revolving account in good standing.
- One in three files (33 percent) was missing a mortgage account that had never been late.
- Inconsistent reporting by the agencies on whether a consumer was late in making a payment was widespread. Wide disparities existed in reporting 30-day delinquencies (on 43 percent of files), as well as 60-day (29 percent) and 90-day (24 percent) delays.

[8] The specific findings regarding errors of commission and omission are drawn from the smallest sample examined (51 files.) The significant characteristics of that small sample are consistent with those of the larger samples in the study. Furthermore, many of the findings are consistent with those reported in research by the Federal Reserve and other parties.

- Reporting on credit limits and balances was almost universally inconsistent (on 96.1 and 82.4 percent of files, respectively). This is significant as the proportion of balances to available credit was one of the most frequently identified factors affecting a consumer's credit score. One file in six listed the utilization rate as the primary reason for the score.

B. Federal Reserve Board Study raises concerns about incomplete and duplicate reporting.

The Federal Reserve Board earlier this year published a comprehensive study examining the information in consumer credit reports.[9] It found that the information in credit files is not complete, that these files may contain duplicate information and at times are ambiguous about some consumers' credit status. The study reviewed the credit information in 248,027 consumer credit files from a single national credit repository to determine whether data maintained by credit reporting companies is sufficiently complete, comprehensive, and accurate to serve as a new source of statistical data to evaluate macroeconomic conditions and for other purposes. This study identified several areas of concern regarding the data.

The primary area of concern with data integrity highlighted in this study was that of missing credit limits. About 70 percent of consumers had at least one revolving account in their credit files that did not contain information about the credit limit. Without information on the credit limit, the level of credit utilization – a key factor used in credit evaluation – cannot be determined, and as a result these consumers are likely to be deemed less credit worthy than they are.

The researchers also noted that a large number of accounts had not recently been updated. Among accounts reported with a major derogatory piece of information as the most recent addition, such as a significant delinquency, almost three-fifths of the reports were not current. The researchers concluded that many of these accounts had been closed or transferred, and that it was likely that consumers who had paid off delinquent accounts since they were last reported were being penalized.

This report also cites evidence that some creditors only report derogatory information. Others do not report minor delinquencies. The impact on consumers of these behaviors is mixed. Some may appear more creditworthy as a result, while others may appear less so.

Consumers may also be penalized by the duplicate reporting of collections and public records found in the Federal Reserve study. Items pertaining to the same credit event, such as when a new and duplicate record of a delinquency is added at the time a collection is initiated, and another added at the time a collection is paid. The report concludes that such duplication of these items "could significantly affect credit evaluation."[10]

[9] Avery, Robert, Paul Calem, Glenn Canner, and Raphael Bostic. "An Overview of Consumer Data and Credit Reporting." *Federal Reserve Bulletin*. February 2003. pp. 47-73.
[10] Ibid, at 71.

Most of the problems identified in the study "result from the failure of creditors, collection agencies, or public entities to report or update items."[11] In other words, most of the problems with incomplete and ambiguous data are the result of the actions of data furnishers.

C. The Comptroller of the Currency has publicly admonished furnishers of credit information for abusive, unfair, and anti-competitive selective reporting practices.

In a May 5, 1999 speech before Neighborhood Housing Services of New York, Comptroller of the Currency John 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"[12]. 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 characterized as unfair; it may well be deceptive, and – in any context – it's abusive."[13]

D. The Federal Financial Institutions Examination Council (FFIEC) has raised safety and soundness concerns because of selective reporting by furnishers.

In an advisory letter[14] regarding consumer credit reporting practices, the FFIEC reported that "certain large credit card issuers are no longer reporting customer credit lines or high credit balances or both. In addition, some lenders as a general practice have not reported any loan information on subprime borrowers, including payment records. The Agencies have been advised that the lack of reporting is occurring primarily because of intense competition among lenders for customers." Rather than requiring lenders to report more completely, the letter provides guidance to financial institutions to take extra measures in their risk analysis to account for the missing information, to avoid exposure to credit risk that could affect their safety and soundness.

E. Other research confirms high rates of inaccurate and incomplete information in credit reports.[15]

[11] Ibid, at 73.
[12] http://www.occ.treas.gov/ftp/release/99-41a.doc
[13] http://www.occ.treas.gov/ftp/release/99-51a.doc
[14] FFIEC Advisory Letter. January 18, 2000. Available at: http://www.ffiec.gov/press/pr011800a.htm
[15] Ironically, a study conducted for the credit reporting industry that purports to show that very few credit reporting inaccuracies exist, may actually demonstrate that consumers who review their reports are likely to find errors. In 1991, the Associated Credit Bureaus (now the Consumer Data Industry Association) commissioned an analysis from Arthur Andersen. This study, completed in 1992, found that very few consumers who are denied credit request their credit reports (7.7 percent or 1,223 out of 15,703 consumers). However, 25 percent of consumers who reviewed their credit reports (304 out of 1,223), found and disputed errors, and 13 percent of disputes that had been completed by the time of the study (36 out of 267) resulted in a reversal of the original negative credit decision. The often cited finding that this study proves a 0.2% error rate is a somewhat misleading conclusion, because it is arrived at by comparing the number of credit reversals with the number of consumers in the sample (36 out of 15,703). It ignores the fact that 92.3% of the consumers in the study never saw their credit reports and were therefore unable to make

Over the past decade, surveys and research conducted by the Industry Group National Association of Independent Credit Reporting Agencies (now the National Credit Reporting Association)[16], and by the U.S. Public Interest Research Group[17] and Consumers Union[18] have documented inaccuracies in as many as 70 percent of credit reports. Among other problems, these studies identified false delinquencies, mistaken identities, uncorrected errors, missing information, and duplicate reporting of information in credit reports.

II. The ability of consumers to identify and dispute inaccuracies in their reports and scores is severely limited.

A. Loopholes in the law and the growth of "risk-based" mortgage lending may endanger consumer rights under the FCRA to be informed of and challenge adverse credit decisions.

Many consumers do not see their credit reports until they suffer an adverse action based on the information in those reports, such as having a loan or insurance application denied, being charged higher than prime rates, or receiving less favorable terms, and are told of their right under the FCRA to receive a free copy of their credit report. Such adverse action notices are usually the catalyst for consumer to exercise their right to review and dispute information in their credit reports. However, there are substantial threats to the effectiveness of this pivotal component of the statute. The trend towards "risk-based" pricing in the current marketplace increasingly means that an "adverse offer" is not the wholesale denial of credit, but an offer of credit at less than the most favorable terms. For this reason, several of FCRA's provisions regarding adverse actions need to be updated to ensure that consumers have access to their rights when they receive a credit offer with higher rates or stricter terms.

First, a loophole in the law regarding so-called "counteroffers" increasingly reduces the efficacy of adverse actions provisions. If a consumer is denied the best credit rate or terms available, but accepts an offer for credit at less favorable terms, they are not entitled to a free copy of their report, or a notice that they have been subject to an adverse action based on information in a consumer report. When applying for a mortgage, many consumers generally identify the type of mortgage they would like to apply for and the amount they wish to borrow, rather than applying for a specific rate. When told about the rate for which they qualify, they are not necessarily in a position to assess whether this rate is unfavorable. Furthermore, many subprime borrowers are unlikely to be alerted to potential mistakes in their credit files that could raise their rate. While increased access to credit is a laudable goal if the loan is not offered on predatory terms and it is sustainable by the consumer, this significant change in the marketplace

---

any determination as to their accuracy. Furthermore, the study considers only those errors that were significant enough to result in a reversal of the credit denial. Given the sweeping changes in the industry since the study was conducted, including the rise of risk-based pricing, the present impact of smaller errors on consumers should not be overlooked.

[16] *Survey/Study Three Bureau Merged Infile vs. Two Bureau Residential Mortgage Credit Report.* National Association of Independent Credit Reporting Agencies. March 1994.

[17] *Mistakes Do Happen.* Public Interest Research Group. March, 1998.

[18] "Credit Reports: How do potential lenders see you?" *Consumer Reports.* July 2000. P. 52-3., and "Credit Reports: Getting it Half Right." *Consumer Reports.* July, 1991. p. 453.

requires a re-evaluation of the mechanism and circumstances under which consumers are given free access to their credit reports.

B. The current statute does not provide access for consumers to sufficient information to make informed assessments of the impact of errors in credit reports.

Despite the fact that many lenders may rely heavily or even exclusively on a credit score to make a credit decision, the consumer has no right under FCRA to see the score used to evaluate them. Moreover, even with notice of an adverse action, the current statutory requirements do not give consumers access to the actual information used by a lender to evaluate their application. In mortgage lending situations, this usually involves a "tri-merged" report with data and scores from all three major credit bureaus. Instead, consumers who request a report received a "cleaned up" copy generated by the identifying data the consumer submits, which is more detailed than the information that lenders are required to submit. Credit reports are generated from large databases of information based on the information included in a query. Depending on the amount of identifying information included in the query, the report and credit score will be substantially different. In particular, credit files are more likely to include mixed information from individuals with similar names, addresses and social security numbers, if very little identifying information is used to obtain the file. This incorrect information will not be apparent to the consumer if the file he or she receives is different than that received by the lender. Moreover, as the findings of the CFA/NCRC report show, the explanations provided to consumers about the reasons for adverse credit decisions are usually vague and unhelpful.

III. Public Policy Recommendations

A. Broaden consumer access to credit reporting and scoring information. Empowering consumers with more and better information is the key to improving the accuracy and fairness of the credit reporting system.

1. Require credit reporting agencies to grant consumers one free credit report and credit score per year upon request. Rather than waiting for an adverse credit decision to check their report and score for accuracy, consumers should be given the opportunity to get the information once a year at no charge. Consumers should be given a description of the major factors that are used to calculate the score, the weight of each factor in calculating the score and how the consumer rated on each major factor. Moreover, consumers should be given a copy of the report a subscriber would get, which is generated by less matching information about an individual than a consumer is required to submit. This allows the consumer to see if his or her file contains mixed or unrelated credit information for someone else with a similar name or address.

B. Require credit furnishers to provide more accurate and complete information. As this testimony has demonstrated, many errors in credit reports can be attributed to the practices of creditors and other credit data furnishers. Credit Reporting Agencies must meet a "maximum possible accuracy" standard but obviously rely heavily on the information that is furnished to them.

1. Increase the legal standard of accuracy for credit furnishers. The current accuracy standard under section 623(a)(1)(A) is quite weak and has not provided an adequate incentive for data furnishers to provide accurate information. It forbids furnishers from providing data to credit bureaus only if "they know or consciously avoid knowing that it is inaccurate." Unlike the requirement in Massachusetts—which was allowed to stand when the 1996 amendments to FCRA were made—this standard does not require furnishers to know if information they are submitting to a credit reporting agency is actually accurate. A standard more consistent with many other consumer protection laws would be to forbid furnishers from reporting information if they "knew or should have known" it was incorrect.

2. Require furnishers of data to provide complete information on any account for which they use a credit report or score to determine eligibility, pricing or for account reviews. 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 report complete information back to the credit repositories, including "positive" payment information and information in all data "fields," including credit limit information and the date of last activity. 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.

3. Require data furnishers to notify consumers any time derogatory information is submitted. Congressman Ackerman has laudably pointed out that such a requirement would offer consumers the opportunity to check the accuracy of derogatory information when it is submitted, as opposed to finding out the next time the consumer applies for credit and is turned down or offered a high interest rate.

4. Prevent duplicate reporting of accounts by preventing credit furnishers from reporting a debt once it is sold or sent to collection. Collection agencies will report this information once they own the account. Credit furnishers should be required to report to credit bureaus when they have sold an account and should be forbidden from reporting information about an account once they no longer own it.

C. Require credit bureaus to distribute more accurate information to the users of credit reports.

1. Require that data provided for credit reports be generated through the accurate matching of at least four of points personal information about the specific consumer who is applying for credit. The amount and type of identifying information provided by creditors requesting a report should be as detailed as that required for consumers requesting their own report or score. This will make it more likely that the credit report that is pulled does not contain "mixed" data from another consumer with a similar name, social security number or address.

2. Require credit bureaus to prevent the reinsertion of fraudulent or erroneous account information that has been previously deleted. There have been repeated complaints that

information that is deleted by a bureau because of an inaccuracy or identity theft is reinserted when the data furnisher submits subsequent routine updates of account information.

D. Modernize the FCRA dispute resolution process.

1. Allow consumers access to the actual credit report and score that were used to make the credit decision. Creditors should immediately provide to any consumer who experiences an adverse credit action 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 have experienced an adverse action based on one or more credit reports or scores 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.

2. Improve the explanations offered to consumers for why adverse credit actions are taken and offer the consumer the opportunity to correct errors and be immediately reevaluated for the most favorable credit terms. The FCRA and Equal Credit Opportunity Act require lenders to inform consumers that an adverse credit action has been taken. Such an action includes, among other things, denial of credit or the denial of favorable terms on credit. Lenders must also inform consumers what the principal reasons are for the adverse action. As cited above, CFA and NCRA have found that most of these explanations are either vague, duplicative or both. Instead, lenders should be required to identify any specific entries (trade lines) that are lowering the consumer's score and indicate the impact on the consumer (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.

3. Shorten the deadlines by which creditors must respond to consumer disputes about credit information. Currently, the FCRA provides creditors 30 days to respond to a dispute; 45 days if the consumer submits additional documentation about the dispute. In the age of "instant credit" and three-day credit re-scoring by credit reporting resellers, these deadlines are much too long. By the time the consumer hears back from the credit bureau about the outcome of the dispute, he or she might have lost a home loan (and the home) or submitted to a loan at a higher rate than he or she was entitled to. Given how fast credit decisions are now made, resolution deadlines of ten days (fifteen if the consumer submits additional information) do not seem unreasonable.

4. Require creditors and credit bureaus to meet reasonable minimum standards when "reinvestigating" a consumer complaint. As documented in detail in last week's testimony by the National Association of Consumer Advocates and the National Consumer Law Center, the current automated reinvestigation process used by creditors and bureaus almost always results in creditors verifying that the original data they provided about a consumer is accurate. Credit bureaus are not required to make an independent determination about whether the information that is provided about a dispute is accurate, even if that information comes from an independent third party rather than the furnisher or the consumer. They simply submit a numerical code to a furnisher about the nature of the complaint and ask the furnisher to verify whether the complaint

is accurate or not. Creditors are not asked by credit bureaus to examine the original documents provided in a dispute to determine their veracity.

5. 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 lenders reduce costs by underwriting certain decisions with only one credit report. For example, a lender may offer pre-approved credit cards 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 reports 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.

6. Require creditors to identify any offer of credit at less than the most favorable terms as an "adverse offer." This would include pre-screened "subprime" mortgage offers or credit cards solicitations that are based on negative or less than favorable credit information. As is well known, the subprime credit industry has boomed in the past decade by offering borrowers with blemished or limited credit histories mortgage loans, car loans and credit cards at higher rates and less favorable terms than offered to their "prime" borrowers. As lenders increasingly offer a continuum of loans at different rates and terms, it is more important than ever that consumers have the ability to exercise their FCRA rights to insure that adverse credit information is correct. In the world of "risk-based" pricing, borrowers should know that they are being targeted because of their less than optimal credit history and should be offered the opportunity to check their credit history and change any information that is not accurate or complete. Furthermore, as stated above, many consumers are unwittingly giving up their FCRA rights because they are accepting loans that are legally considered "counteroffers."

D. Improve oversight of credit scoring. End credit scoring misuse for insurance purposes.

1. 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 appropriate government agencies, such as HUD, the Federal Trade Commission,

and state insurance departments should 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 score 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 systems that identifies and protects consumers from any discrimination or abuses will foster consumer confidence in these powerful and increasingly utilized evaluation tools.

2. End the use of credit scoring for insurance purposes. The states of Hawaii and Maryland have forbidden the use of credit reporting data for the purpose of underwriting or pricing some forms of insurance. This is because insurers have not shown that credit data is logically related to a consumer's likelihood of incurring or filing a claim. These states have rightfully concluded that the contention that it is not enough to contend, as insurers have, that there is a correlation between credit history and claims. There may be a correlation between the color of someone's hair and their likelihood of filing an insurance claim, but that doesn't mean that it is logical or reasonable to charge people with red hair higher rates, or to refuse to cover them. What does a person's credit history have to do with the likelihood that a hailstorm will damage their roof and that he or she will file an insurance claim? Congress should follow the example of these two states and forbid the use of credit data for insurance purposes.

E. Broaden federal enforcement of the FCRA.

1. Appropriate federal agencies should conduct regular credit bureau FCRA compliance audits. An appropriate federal agency, 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.

2. The Federal Trade Commission should collect, analyze and disclose information about credit reporting disputes. Credit bureaus should disclose to the FTC on a quarterly basis data about all disputes filed by consumers, the identity of the furnisher who provided the information in dispute, the outcome of the reinvestigation and the amount of time that the reinvestigation took. The FTC should be required to present an annual report to the Congress that aggregates this data, analyzes the causes and outcomes of consumer disputes and offers public policy remedies to solve endemic problems.

F. Legally empower consumers to combat credit reporting inaccuracies and abuses. Although federal and state authorities should do more to enforce the requirements of the FCRA, a handful of agencies will never be able to adequately keep track of problems involving more than 190 million credit reporting files. The combined restrictions on private enforcement of the act make it extremely difficult for consumers to hold credit furnishers and bureaus accountable for major violations of the law.

1. Make it easier for consumers to pursue a claim against creditors who report wrong information. Consumers can only enforce the already weak accuracy standard for data furnishers (mentioned above) under very narrow circumstances involving the reinvestigation of a credit reporting problem. As a result, virtually no private actions against creditors have been successful, even for grievous reporting errors.

2. Increase legal deterrents to egregious violations of the law. Several courts have held that the FCRA does not allow injunctive relief for consumers. Broadening this right will allow courts to prevent bureaus from issuing credit reports with false or disputed information. The law should also grant successful plaintiffs minimum statutory damages for egregious violations of FCRA, such as the failure to correct inaccurate information after notice is provided. This will provide a further deterrent to consistently sloppy and inaccurate reporting. And finally, because of a recent Supreme Court decision[19], it is necessary to reinstate the previous rule that consumers have two years from the date of discovery of an error (as opposed to the date the error occurred) to file suit. Chairman Bachus and Representative Schakowsky have proposed legislation, H.R. 3368, which would laudably restore a reasonable statute of limitations for these claims.

G. Improve baseline federal credit reporting standards. Allow states to exceed these minimum standards, as long as state law does not conflict with federal law.

1. Improve federal law. As identified above, the FCRA needs to be modernized and improved to insure greater accuracy of information and to prevent misuse and abuse of credit reporting and scoring information. This will benefit creditors, credit bureaus, and consumers.

2. Allow federal preemption of state credit reporting laws to expire. The eight specific areas of federal preemption that were put in place for the first time in 1996[20] expire on January 1, 2004. If federal credit reporting consumer protections are broadened and improved, very few, if any, states are likely to attempt to exceed these baseline standards. However, the expiration of these preemptions would allow some states the opportunity to quickly respond to the particular needs of their states' residents. This is what Vermont did in 1991, when residents of entire towns were victimized by the systemic misreporting of false credit reporting information. It is always a good idea to require meaningful consumer protections in the least economically burdensome manner possible. However, to date, we have not heard a factual basis for the rather hysterical contention that the expiration of these preemptions will result in the passage of many burdensome state laws that will drive costs to consumers up, make credit unavailable to borrowers in some states and result in a "balkanization" of the credit system. In fact, testimony put on the record by the Assistant Attorney General of the State of Vermont and the U.S. Public Interest Research Group last week documented that fair credit reporting standards have always been developed and

---

[19] Andrews v. TRW, Inc., 534 U.S. 19 (2001).

[20] Under 15 USC Section 1681t(b)(1), these preemptions affect: (1) prescreening of consumer reports by credit reporting agencies; (2) timelines by which a consumer reporting agency must respond to consumer disputes; (3) the duties of users of credit information that make adverse decisions; (4) the duties of a person using a consumer report in connection with a credit or insurance transaction not initiated by the consumer; (5) the type of information in a consumer report; (6) the responsibilities of furnishers of information to credit reporting agencies; (7) sharing of credit reporting information among corporate affiliates; (8) the form and content or disclosures that must be offered to consumers. Some stronger state laws were allowed to continue to exist under these provisions.

enforced at both the national and the state level. As cited in these testimonies, there are a number of state laws that exist right now that either: (a) already exceed federal standards on preempted laws because they were "grandfathered" in as part of the 1996 FCRA amendments, or (b) exceed federal standards on non-preempted credit reporting laws. Proponents of continued preemption have not offered evidence that any of these laws, such as the California law that holds credit furnishers to a higher standard of accuracy than federal law, have led in any way to reduced credit extension or higher costs for credit for consumers in these states. On the other hand, these laws have led to increased protections for consumers in those states, which is very positive. Continuation and expansion of a rational federal/state system of credit reporting standards is the best way to both provide some predictable baseline requirements for creditors and credit bureaus, while providing the best and most responsive protections for consumers.

Thank you again for the opportunity to offer our views and recommendations. We look forward to working with you, Mr. Chairman, and the members of this subcommittee to improve the Fair Credit Reporting Act for consumers.

Written Testimony of Mike Vadala

President/CEO of The Summit Federal Credit Union

On Behalf of The National Association of Federal Credit Unions

Subcommittee on Financial Institutions and Consumer Credit

United States House of Representatives

Fair Credit Reporting Act

June 12, 2003

National Association of Federal Credit Unions

3138 10th St. North

Arlington, VA 22201

(703) 522-4770

Introduction

The National Association of Federal Credit Unions (NAFCU) is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU is comprised of approximately 900 federal credit unions -- financial institutions from across the nation -- representing approximately 24 million individual credit union members. NAFCU–member credit unions collectively account for approximately two-thirds of the assets of all federal credit unions. NAFCU and the entire credit union community appreciate this opportunity to participate in the discussion regarding the Fair Credit Reporting Act (FCRA) and its effects on America's consumers.

Historically, credit unions have served a unique function in the delivery of financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was recognized as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have no access to credit. Congress established credit unions as an alternative to banks and to fill a precise public need—a niche that credit unions fill today for over 82 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 USC 1752(1)). While nearly 70 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

> Credit unions remain totally committed to providing their members with efficient, low cost personal service; and,
>
> Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's approximately 9,600 federally insured credit unions serve a different purpose and have a fundamentally different structure, existing solely for the purpose of providing financial services to their members. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union —"one member, one vote" - regardless of the dollar amount members have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors. Unlike their counterparts at banks and thrifts, federal credit union directors, serve without remuneration — a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Credit unions have never cost the American taxpayer a dime. Unlike the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loans Insurance Corporation (FSLIC) – the precursors to Bank Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF) – that were started with seed money that came from the United States Treasury, every dollar that has ever gone into the National Credit Union

Share Insurance Fund (NCUSIF) has come from the credit unions it insures. And unlike the thrift insurance fund, credit unions have never needed a federal bailout.

America's credit unions have remained true to their mission of "promoting thrift" and providing "a source of credit for provident or productive purposes." In fact, Congress acknowledged this point when it adopted the *Credit Union Membership Access Act* (CUMAA – P.L. 105-219). In the "findings" section of that law, Congress declared that, "The American credit union movement began as a cooperative effort to serve the productive and provident credit needs of individuals of modest means ... [and it] continue[s] to fulfill this public purpose."

Today, credit unions play an important role in the lives of millions of Americans from all walks of life. As the package of financial services offered by various financial institutions becomes ever more homogenized, the emphasis has begun to shift from types of service to quality and cost of service. Credit unions are second to none in providing their members with quality personal service at the lowest possible cost. According to the 2002 *American Banker*/Gallup Consumer Survey, credit unions had the highest rated service quality of surveyed financial institutions. This has held true each year since the survey was initiated -- a trend that shows no sign of changing.

As well as serving on the Board of NAFCU, I also serve as President and CEO of The Summit Federal Credit Union. The Summit Federal Credit Union is a multiple group credit union serving over 43,000 members nationwide. Most of the members are served out of five branch locations and the credit union headquarters in Rochester New York. Although there are approximately 41,000 members in New York, we do have at least one member in all 50 states including at least 100 members in seven states and at least 20 members in an additional seventeen states. Because of this there is a great likelihood that at any given point in time The Summit Federal Credit Union will have consumer loans outstanding in anywhere from 25 to all 50 states. Due to the different laws that exist on a state by state basis, The Summit does not engage in real estate lending outside of New York, but does extend credit for all other consumer purposes in all 50 states.

The Fair Credit Reporting Act

The foundation of America's national consumer credit system is the Fair Credit Reporting Act, enacted by Congress in 1970 to streamline credit reporting and provide consumers with protection from inaccurate and inappropriate disclosures of personal information by consumer reporting agencies. Consumer reporting agencies collect and compile information about consumers' creditworthiness from financial institutions, public records, and other sources. Today, millions of small and large businesses rely on consumer reporting agencies information to help provide services and products to consumers. Consumer reporting agencies in this country currently maintain credit files on more than 180 million adults and track more than two billion transactions per month.

The Fair Credit Reporting Act was strengthened in 1996 in response to consumers' concerns that businesses that provide information to the consumer reporting agencies were not being held accountable for their accuracy, and that consumer reporting agencies were unresponsive to consumer inquiries and disputes. As a result of these concerns, amendments were added to the bill to establish strong national operating standards intended to preserve the efficiencies of the credit reporting process while ensuring that its benefits extend to consumers across the country.

In 1996 the Fair Credit Reporting Act was amended and now contains seven specific federal preemptions to ensure that the national consumer credit system remains viable and can continue to deliver affordable and accessible credit and financial services to consumers. Federal consumer credit laws that apply nationally regulate the following areas and include provisions that preempt states from regulating or changing:

1. the responsibilities of organizations and businesses that furnish information to consumer reporting agencies;

2. the duties of organizations and businesses to notify consumers when they have been denied credit or employment based on information in their credit reports;

3. procedures that a consumer reporting agency must use if a consumer disputes the accuracy of information;

4. the information that may be included in consumer reports, including the time periods during which consumer reporting agencies are permitted to report adverse information;

5. the form or content of the summary of rights that a consumer reporting agency is required to provide to a consumer along with information in the consumer's file;

6. the exchange of information among affiliated institutions; and

7. prescreening activities to provide consumers with credit or other financial service or product offerings.

These provisions are set to expire on January 1, 2004 unless they are extended by Congress. NAFCU agrees with Federal Reserve Board Chairman Alan Greenspan and Treasury Secretary John Snow that Congress should permanently reauthorize the provisions of the Fair Credit Reporting Act. Reauthorizing these Fair Credit Reporting Act provisions will give credit unions the ability to continue to offer their members credit in a timely manner at a fair market price.

Reauthorizing these provisions of Fair Credit Reporting Act would also codify the ability of credit unions to share certain member information with their affiliates – thus giving credit union members the ability to obtain additional financial services of which they might be otherwise unaware. This law, combined with the privacy provisions of the 1999 Gramm-Leach-Bliley Act (P.L. 106-102), has gone a long way in protecting the privacy rights of America's consumers.

Failure to reauthorize these preemptions would drastically change the way a credit union is able to conduct business in today's financial marketplace. A credit union such as mine, with members in 50 states, could be forced to comply with fifty different state laws. As you may know, credit unions on average are small financial institutions and many may not have the resources necessary to comply with differing laws across the 50 states. They would, therefore, be forced to forgo lending in many states in which they have members. This would result in the potential of millions of consumers losing a viable lending option and may make smaller credit unions less competitive in today's financial marketplace.

National System Benefits

From law enforcement to child welfare enforcement agencies, a variety of public sectors rely on our national credit system to provide accurate and comprehensive consumer credit information.

> ***Credit Unions and Banks:*** National and local credit unions and banks rely on the national credit system to assess lending risk, manage portfolios, detect fraud, acquire new members or customers and grow those relationships. Restricting access to this information would likely increase lending losses, driving up costs for consumers.
>
> ***Employers:*** Information from the national credit system is a helpful tool for verifying an applicant's identity, reducing application fraud, and finding indicators of financial risk. In addition, this information is a valuable component of background checks for teachers, bus drivers, day care centers and others who children are entrusted to on a daily basis.
>
> ***Utilities:*** Each year, more than 40 million Americans move to a new address and must sign up with new utility providers. These companies depend upon the national credit system for information on new customers' identities and to assess risk of non-payment.
>
> ***Retailers:*** Without the national credit system, consumers could not apply for instant credit, and the application process for store loans for larger purchases would be longer, far more complex and result in fewer approvals.
>
> ***Law Enforcement Agencies:*** Credit information is a critical tool for locating criminal and terrorism suspects and potential witnesses, identifying suspects or verifying their identities, and assisting in investigations.
>
> ***Mortgage Brokers:*** This year, more than 6.5 million Americans will apply for new home loans, and millions more will refinance existing loans. The mortgage lenders and bankers processing these applications and making the loans use information from the national credit system to make sure loans are sound and to provide consumers with the best possible rates.

Internet Companies: Information from the national credit system allows companies to prevent fraud in online financial transactions by verifying and authenticating the identities of their customers.

Child Welfare Enforcement Agencies: The national credit system helps enforce child support payment by allowing missed payments to be added to a parent's credit report and providing information to help locate parents and enforce the law.

Automobile Dealers: Americans who are creditworthy are able to purchase automobiles within hours because dealers are able to rely on the national credit system to make risk decisions on "instant loans."

Wireless Communications: Americans are able to establish cellular phone service immediately when purchasing a new phone, because service providers are able to use information from the national credit system to instantly evaluate at the point of sale the risk that a consumer will not pay bills, to validate the content of the application and verify the identity of the applicant.

Credit Card Companies: More than 185 million Americans have credit cards, yet fewer than 3 percent make late payments each month. Credit card companies are able to keep this rate so low by using information from the national credit system to identify potential new customers, minimize lending risk, prevent fraud, manage customer portfolios and improve customer relationships and experiences.

Credit Union Consumer Lending Programs and the Use of Credit Scoring and Credit Reports

While it is true that many credit unions do a variety of lending, the vast majority of loans made by credit unions are consumer loans. As an industry, we are very good at making these loans, and our experience allows us to use the various tools that are available as well as our understanding of our members and communities to be successful.

Credit scoring and credit reports are critical to the operational needs of most consumer lenders, and they are critical to our credit union's operations. These items are two of the best active tools for evaluating the credit worthiness of borrowers, and coupled with experience and judgment, have allowed us to establish a very successful lending program at our credit union.

We feel strongly that credit scoring, credit reports, experience and judgment work together to contribute to good lending decisions. We have found that credit-scoring modules are statistically valid, and that the accuracy of credit reporting and credit scores are much improved over what they used to be. We also acknowledge that at times there are errors in credit reports, but we are pleased with the improvement that we have seen in recent years. And we have also found that many times well-trained credit officers can find these errors, and that credit decisions are in most cases made independent of these errors after an appropriate investigation.

Using Credit Reports

Certainly there are times when erroneous information appears on a credit report that just does not make sense. We rely on the experience, training, and judgment of the loan officer to detect these errors. One example might be a delinquent mortgage obligation when the member has indicated that he or she rents. Another may be when a person has clean credit and one bill that shows a delinquent repayment record, which is inconsistent with the rest of the report. These should be red flags for a loan officer and should be questioned immediately.

Another way that errors in credit reports are detected is through comparing discrepancies between the debts listed on a member loan application and those reported on a credit report. The credit union loan officers understand that some members simply forget to list all of their debts; we also realize that it is possible on rare occasions, that people with common last names or other similar characteristics can be mistaken for one another, and items can find their way onto other peoples' credit reports. The way to find these mistakes is simple. What we try to do is talk to the member. In a perfect world we can contact these people by phone, and they will be easily reached. This is not always the case, and at times we need to send a letter, possibly rejecting the loan, and wait for a response or appeal.

Errors aside, credit reports are VERY valuable tools as they serve to verify that a member has listed all his or her debts on a loan application, and these reports subsequently provide details as to the payment history on those debts. In this day and age, consumers have more credit lines at more places than ever, and it is very unusual that a member remembers to list all of his or her debts on an application, and further, the repayment history gives rise to some significant information about how responsible the member is in handling his or her obligations. More members than ever are opening credit lines with providers in multiple states. That said, it would be unreasonable for the requirements for reporting to be inconsistent from state to state. Allowing for a consistent method of credit reporting allows us to get the information that we need to have important conversations that are necessary to extend credit responsibly to our members. The current federal preemptions satisfy these needs, and we strongly urge that they be extended.

Credit Scores

Credit scores are another important tool that can be used in the extension of credit. The most important ways that credit scores are used include the automatic extension of credit and as a predictor of losses that could occur based upon a variety of factors that appear in the member's credit history. Some important facts about credit scores include:

1) Scores are developed solely on the member's own loan portfolio experiences. They are independent of race, income, religion, etc.

2) Scores help to forecast specific risk levels associated with individuals. On a national level, credit scores are as follows;
   a. 700 and above - 60% of population
   b. 650-699 – 16% of population
   c. 600-649 – 11% of population
   d. Under 600 – 13% of population

There are about 50 factors that contribute to credit scores, but the most important factors that contribute to credit score are as follows[1]:

1) Repayment History – 35% of score
   a. Payment information on specific types of accounts.
   b. Severity of delinquencies.
   c. Time since last past due item.
   d. Number of past due items.
   e. Number of accounts paid as agreed.

2) Amount of credit owing – 30% of score
   a. Includes amount due on loans.
   b. Amount on specific types of loans.
   c. Numbers of loan accounts with balances.
   d. Lack of a specific type of account in some cases.
   e. Proportion of balances due compared to original loan amounts.
   f. Proportion of credit lines used and capacity to borrow.

3) Credit History – 15% of score
   a. How long have you had credit.

4) New Debt – 10% of score

5) Credit Mix – 10% of score

Impact of Credit Scores

Credit scores can be used in several ways. At the Summit Federal Credit Union we use them as follows:

1) Automatic Approval - At The Summit Federal Credit Union we use credit scores to facilitate automatic approval of loans (no loan officer interaction), but do not use credit scores as an automatic rejection of loans. If a score is lower, it guarantees that the application must be reviewed and handled by a loan officer.

---

[1] U.S. News & World Report, February 5, 2001, Personal Finance: Credit Score Card

2) Loan Rate – We have used credit scores to predict risk and to assign loan rates for over five years, and have a significant statistical sample to use in the evaluation of the success of this program. Those members with higher scores will get lower loan rates. In general, members who have historically paid their debts, and managed credit well will get the best rates. We use a combination of our actual experience and national data for those borrowers with similar scores to set rate margins annually.

   a. Loan Rates offered as of May 31, 2003:
      i. "A" Rates – 680 and up – best rate
      ii. "B" Rates – 660-679 – best rate + 1.00%
      iii. "C" Rates – 620-659 – best rate + 1.75%
      iv. "D" Rates – 580-619 – best rate + 3.00%
      v. "E" Rates – 580 and below – best rate + 8.00%

   b. Statistically Valid – Our top scoring members have delinquent ratios, as follows;
      i. "A" rates – 680 + up – 0.13% Delinquency; 0.11% Charge Offs
      ii. "B" rates – 660-679 – 0.23% Delinquency; 2.11% Charge Offs
      iii. "C" rates – 620-659 – 1.65% Delinquency; 1.73% Charge Offs
      iv. "D" rates – 580-619 – 1.65% Delinquency; 3.75% Charge Offs
      v. "E" rates – under 580 – 20.29% Delinquency; 11.31% Charge Offs

Consumers and Credit Score

In general, people know that when they do not manage their debts properly, that fact will show up on their credit report and hurt their "credit rating". But, there is very little knowledge on the part of consumers regarding the existence of credit scores, how they are used in determining rates, and how they can be improved upon. Even lenders cannot tell consumers all of the specifics, as some of the information is proprietary. We have sent people from our staff to seminars, and we have passed such information on to our members in response to inquiries.

Ideally, we would like to establish a new program at The Summit Federal Credit Union to educate our members to some degree on their credit scores. Today it is only being done on a case-by-case basis as members ask for an explanation. Our vision is to educate staff and then to advertise the service.

Conclusion

NAFCU believes that the state of the credit union community is strong and the safety and soundness of credit unions is unquestionable. Nevertheless, we urge the Subcommittee to carefully assess this issue and reauthorize the preemptions included in the FCRA. We understand that there is much work to be done by the Subcommittee and we urge the Subcommittee to undertake a careful examination of what other measures fall within the scope of this legislation that will address the concerns we have articulated.

NAFCU thanks the Subcommittee for the opportunity to make this statement before you today and commends the House Financial Services Committee for examining these important issues. We look forward to working with you on this important piece of legislation and would welcome your comments or questions.

Testimony

of

Martin Wong
General Counsel
Citigroup
Global Consumer Group

Before

The
House Committee on Financial Services
Subcommittee on Financial Institutions
and Consumer Credit

Hearing
on
"The Role of FCRA in the Credit Granting Process"

June 12, 2003

Good morning, Chairman Bachus, Ranking Member Sanders, and Members of the Subcommittee. My name is Martin Wong and I am the General Counsel of Citigroup's Global Consumer Group. Citigroup thanks Chairman Bachus and Chairman Oxley for their leadership in holding these hearings on the Fair Credit Reporting Act ("FCRA") and I appreciate the opportunity to speak before you today to discuss how FCRA impacts our ability to operate efficiently and serve our over 200 million customer accounts.

As one of the largest diversified financial services companies in the United States, Citigroup has extensive experience with FCRA and has a significant interest in seeing that it continues to operate successfully. Citigroup currently serves customers in all fifty states and over 100 countries across the globe. Citigroup has long been a leader in using the information available through the credit reporting system to provide credit opportunities to customers of all different income levels through a diverse range of financial products and services, including credit cards, mortgages, consumer finance, student loans, and auto loans. We also offer non-credit products, including retail banking, private banking, life insurance and annuities, asset management, and investment products.

Today, I want to emphasize the importance that Citigroup attributes to reauthorizing the national standards contained in FCRA. FCRA provides a national framework for the credit reporting system, which has been shown to work well and to provide substantial economic benefits to consumers. It appropriately balances a wide range of consumer protections with the crucial need for creditors to have access to a uniform national database on which to make credit decisions. It is essential, therefore, that Congress act to preserve the national framework that is scheduled to expire at the end of this year.

Importance of FCRA

The credit system that has developed under the uniform framework of FCRA is highly efficient and provides substantial benefits to consumers in the form of affordable credit, wide credit availability, and convenient access to credit products. Most recently, it has allowed millions of consumers to take advantage of lower interest rates and refinance their mortgages, because it has allowed nationwide creditors like Citigroup to depend upon these nationwide databases to make efficient decisions. The breadth and uniformity of the nationwide databases are also important for fraud control and prevention of identity theft.

There are seven core provisions in FCRA currently governed by national standards that are scheduled to sunset at the end of this year:

- Sharing information with affiliated companies;
- Prescreening;
- The content of consumer credit reports;
- Accuracy requirements and dispute resolution;
- Furnisher obligations;
- Adverse action duties; and
- Notice of consumer rights.

Allowing the states to change the provisions in any of these areas could undercut FCRA and its substantial benefits to consumers and the economy. State variations could undermine the uniformity of the national databases and upset the important balance that the FCRA strikes between consumer protection and the benefits that flow to consumers from a nationwide system of credit reporting.

While maintaining national standards for all of these key provisions is crucial, I want to highlight a few areas that are especially important to Citigroup and explain why they affect our ability to continue to serve our customers well.

Affiliate Sharing

Citigroup shares information among our affiliates for many important reasons. The shared information may include credit application and credit bureau data, as well as information on our transactions with the customer. This data is valuable for controlling credit risks, credit monitoring, fraud control, and compliance with various obligations under federal law. It also is important in identifying products and opportunities that may be beneficial and of interest to customers. Additionally, customer-supplied information may be used in multi-affiliate operations for pre-filling applications to save customers time and annoyance.

Sharing information among affiliates greatly assists in the prevention and detection of identity theft. Although some have argued that sharing information increases opportunities for identity theft, information sharing among affiliates actually helps detect unusual spending patterns and habits that are used to identify fraud. It also helps alert consumers to potential fraud or identity theft, because the sooner we detect irregularities, the sooner we can notify the customer, minimizing the effect on the victim. Finally, sharing information among affiliates makes it easier to apprehend the fraudster. It enables us to put together information on suspects that more accurately reflects the amount of fraud they have committed, making it easier for law enforcement to build a strong case.

The ability to share information with affiliates also conforms to customer expectations. For example, when a Citibank customer who has an account in Connecticut (through Citibank, FSB) enters a Citibank branch in New York (Citibank, N.A.) to open another checking account, he or she expects to be recognized as a valued customer and demands a certain level of service and accountability. Similarly, the legal distinction between the two affiliated Citibanks is not relevant to the customer and it should not affect his or her ability to obtain products and services. Corporate structure is usually driven by concerns that do not affect the customer, such as the company's history of acquisitions or by corporate tax, legal, and accounting concerns.

In 1996, Congress struck the appropriate balance between consumer protection and business needs by allowing consumers to opt out of having certain information shared among affiliated entities, but continuing to allow information about a company's own experiences with a consumer to be shared freely among affiliates. This national standard has worked well for seven years. It is particularly reasonable now that the business of providing financial services, especially lending, is no longer restricted by state borders, as consumers have the same opportunities for credit, regardless of where they live.

If different states were allowed to pass laws governing the exchange of information among affiliates, it would significantly disrupt our seamless, nationwide system of serving our customers. It could lead to a never-ending process as states and localities impose different regimes. Compliance with this patchwork of laws would be extremely burdensome and costly for lenders, and ultimately for consumers, and would be likely to cause widespread litigation.

Prescreening

Prescreening is essential for targeted marketing. Credit card issuers and other lenders use prescreening to substantially reduce the costs and increase the efficiency of identifying potential customers. For consumers, targeted marketing is vastly preferable to the most likely alternative -- blanket marketing.

Prescreening greatly reduces barriers to entry in the credit card business. Most new entrants and major competitive initiatives in the credit card industry in the last 20 years were based on prescreening. Our credit card division used prescreening procedures to introduce national marketing of credit cards with competitive rates, attention to card member service, and innovative partnership programs. These industry competitive initiatives have provided consumers with lower interest rates, credit cards without annual fees, and an array of new discount and bonus features.

Prescreening enabled these advances because it is an accurate and critical tool for underwriting credit. It allows financial institutions to provide firm offers of credit to consumers who meet certain established underwriting criteria. This allows institutions to control their risk by targeting those individuals that meet certain credit standards. Additionally, accounts obtained through prescreening have lower loss rates and less fraud than other forms of account acquisition.

The prescreening provisions appropriately balance the need for consumer protection by providing consumers with the ability to opt out. A single toll-free call takes the consumer off the prescreening list for all three major credit reporting agencies. Every prescreened offer clearly advises consumers of this opt out right and provides the toll-free number.

Because of the national uniformity established under FCRA, the prescreening process is the same nationwide. If states were allowed to adopt different rules for prescreening or prohibit prescreening, consumers would not be able to enjoy the same benefits derived from robust competition that they receive today. The ability to evaluate creditworthiness would be compromised, and eventually, those most in need of credit would be the ones to be denied.

Content of Credit Reports

As a result of FCRA, the contents of credit reports are uniform across the country. This is important for creditors such as Citigroup, because underwriting credit is a business of evaluating and managing the risk of consumer default. Uniform guidelines for credit report information allow creditors to price risk more accurately, which results in lower costs for all consumers and more credit availability for consumers with less stable credit histories.

If the FCRA provisions that dictate the content of credit reports were allowed to sunset, an individual state could pass a law prohibiting creditors from reporting to credit bureaus until borrower payments were at least 90 or even 180 days past due. For credit grantors, the result could be disastrous. They would grant credit to consumers who appear to have unblemished credit, but, in fact, could have a very high risk of default.

If creditors are unable to predict accurately whether their loans will be repaid, their credit losses will increase, and these increases can be significant. The universal response of lenders to increased credit losses is to raise interest rates. Total outstanding consumer debt in the United States approximates $7 trillion, most of which was extended in at least partial reliance on FCRA-related databases. If the combined actions of various states raise the average interest cost of credit by just one percent, this would cost U.S. consumers $70 billion every year. As an analogy, consider the implications of a new privacy protection law that would annually require $70 billion of new taxes to fund it. Additionally, creditors would be more hesitant to extend credit, especially to low-income borrowers or borrowers with more spotty credit histories. This could drastically reduce the availability of credit, eliminate instant credit opportunities, and increase the time it takes to get a mortgage or car loan.

Conclusion

In conclusion, Congress must act this year to make permanent the uniform standards established under FCRA. With these uniform standards, the FCRA has created a seamless and reliable U.S. credit reporting system for all consumers, regardless of where they live and where they move. It has created more competition in the financial services industry and allowed companies to better serve their customers through more widely available, affordable, and convenient credit.

Thank you again for the opportunity to appear before this Subcommittee. I would be pleased to answer any questions you may have.

washingtonpost.com PRINT ARTICLE ONLY

Cash-Outs Let Homeowners Share the Wealth

Economists Say Refinancings Have Buoyed the Struggling Economy

By Jonathan Weisman
Washington Post Staff Writer
Sunday, June 8, 2003; Page A01

In the rural northeast corner of Iowa, where dairy farmers struggle with plunging milk prices, school budgets are cut to the bone, and unemployment topped out over 9 percent this spring, Michael and Connie Kuennen are plowing more than $100,000 into their century-old farmhouse.

It's not as if Michael, an industrial technology teacher at Turkey Valley High School near Fort Atkinson, or Connie, a human-resource manager, struck it rich in hard times. But like tens of millions of Americans, they have found the silver lining in an otherwise bleak economic landscape: mortgage rates.

Three times in the past year and a half, the Kuennens have refinanced their mortgage, chasing rates on a 30-year fixed loan from more than 7 1/2 percent to a flat 5. That freed up as much as $150 a month and relieved a whole lot of anxiety pressing on their economic state of mind. That, in turn, buoyed the fortunes of the Come and Save Here lumberyard in Lawler, a nearby Home Depot and the carpenter hired to do the custom trim that would preserve the Victorian look and feel of their house.

"We've almost doubled the size of our house, added vinyl siding, a new roof, dormers, custom cabinets, the works," Michael Kuennen said.

Many economists say it is hard to overstate what falling mortgage rates and a boom in refinancing have meant to the nation's struggling economy. They have mitigated the impact of the 2001 recession and helped fuel moderate growth in consumer spending, the principal reason the economy has continued to expand since early 2002.

For many homeowners, fixed-rate mortgages have locked in a financial advantage that will continue long after the economy recovers and interest rates drift upward.

"These effects are going to last for years," said Phil Colling, a senior economist at the Mortgage Bankers Association of America.

Since 2001, banks will have processed more than 271/2 million mortgage refinances by the end of this year, according to the Mortgage Bankers Association. Out of those, homeowners will have converted more than $270 billion of home equity into cash, either to spend or convert high-interest debt into very low interest loans. At least another $20 billion was freed up in lower monthly mortgage payments.

All told, refinancing will have put about $300 billion into the economy since 2001.

Compare that with the tax cuts of 2001 and 2003 that President Bush and his supporters credit with keeping the economy afloat. By the end of this year, the tax cuts will have added $263 billion to the economy. But because that money has flowed gradually to individuals, businesses, and state and local governments, many real estate economists say it has had far less effect on consumer confidence and spending.

In other words, many homeowners say writing a smaller monthly mortgage check makes them feel like they have more money to spend more quickly than complicated and gradual adjustments in their tax liability. Many homeowners typically overestimate how much extra cash they have gained per year by refinancing, multiplying their monthly gain by 12 while forgetting that lower interest payments will also mean a lower mortgage-interest deduction on their tax returns. And at a time when businesses have cut back their spending on payrolls, plants and equipment, it has been consumer spending that has kept the economy going.

"If I lock in a low interest rate and bring down my mortgage $250 a month, that's $3,000 a year I can spend on other things," said Amy Crews Cutts, deputy chief economist at Freddie Mac, who estimated that lower interest costs now save homeowners $300 million a month. "That's a lot more valuable than what President Bush signed into law [last month], and it continues every year that I keep my house."

Overall housing activity, including construction, sales, refinancing, furnishing and refurbishing, usually accounts for 20 percent to 25 percent of the nation's economy, said David Berson, chief economist at Fannie Mae. It now exceeds 30 percent.

"If during the recession of 2001 and the slow growth last year, housing had been more akin to the '70s, '80s, and '90s recessions, the recession would have been severe," Berson said. "And instead of sub-par growth in 2002, we'd be talking about the recession of 2001 and 2002, and maybe 2003."

If anything, the refinancing boom may be heating up again, as homeowners rush to refinance in anticipation of an uptick in rates. Mortgage loan applications and refinances hit record highs the week of May 30.

The resilience of the housing market during the current slow-down is all the more remarkable because it flies in the face of history, said Donald H. Straszheim, a Santa Monica, Calif., economist who has tracked housing's impact on the economy writ large. Most of the post-World War II recessions were exacerbated, if not brought on, by dramatic slumps in the housing sector, and most recoveries have followed a surge in housing activity.

"If it weren't for housing, we wouldn't have had most recessions," Straszheim said. "It's housing that gives the economy its cyclic nature. It goes way down in recession and way back up during recovery."

The opposite happened this time, which is both good news and bad news. Low mortgage rates, refinancing and the rapid rise in housing prices may have kept the economy afloat, but because the housing sector never sunk, it cannot carry the rest of the economy on its back when it rises.

"The bad news is housing never went down, so it's not going to go up," Straszheim said.

For millions of Americans, their houses have been their lifelines. Jason and Andrea Scott entered the economic boom of the late-1990s in a seemingly can't-lose position: two new economics doctorates from Stanford University, a house in San Carlos, Calif., just north of Silicon Valley, and two steady, well-paying jobs at a legal research firm. In 1997, Jason jumped at a chance to join a Silicon Valley Internet start-up. Two years later, Andrea dropped out of the workforce to raise their two young sons.

Then the bottom dropped out of the Bay Area's high-tech economy. Jason's start-up struggled. The family's income began shrinking rather than growing. But the Scotts had their home. They just completed their third refinancing in five years. They were able to convert a 30-year, fixed-rate mortgage to a 15-year mortgage that they will be able to pay off more quickly, yet they pay $100 a month less.

Better yet, they were able to roll a second, high-rate mortgage into one low-rate mortgage, and even finance their Nissan Pathfinder out of housing equity.

The Scotts are something of a microcosm of the homeowning nation. A recent study by Federal Reserve Board economists found that 51 percent of refinancers who took cash out of their housing equity used it to pay other debts and lower other interest costs. About 43 percent said they had used their cash to make home improvements, and 25 percent used the extra money for consumer purchases, especially cars.

Errol Adels, a Washington-based architect, took out a $50,000 home equity loan to build a $200,000 guest house on his Middleburg estate. He then rolled that loan into a jumbo, $389,000 mortgage that he locked in at 6 percent. His mortgage had gone up, but he has knocked $1,000 a month off his financing costs.

"With the last tax break, I was supposed to get a check for $300, maybe enough for lunch for two for me," Adels chuckled. "But $1,000 a month, that is a substantial impact."

The Federal Reserve study estimated that between January 2001 and March 2002, mortgage refinancing added nearly $23 billion to consumer spending, or about $18 billion a year through the refinancing boom. That's only about a half percent of total consumer spending, or one-quarter percent of total economic activity, but in an economy on the edge of recession, it's significant, economists agree.

There are also economic benefits far less tangible than a new guest house or sport-utility vehicle. The nearly 72 million owner-occupied houses in the country have seen their average prices climb nearly 16 percent since 2000, to $164,000 from $139,000, according to Norm Miller, director of the Real Estate Center at the University of Cincinnati College of Business. That represents an increase in wealth of nearly $1.6 trillion, and it is through that appreciation that homeowners have been able to capitalize on refinancing.

Bruce Hirsh, an employee in the U.S. trade representative's office, has been chasing interest rates for a year. His current, five-year adjustable-rate mortgage on his Dupont Circle home is down to 5 1/4 percent, but he's on the market again.

"No question, when you've got a more relaxed payment schedule, you relax more in terms of how you spend," Hirsh said. "Just psychologically, I can see that I'm just a little less worried."

Many economists struggle to find the downside to all of this. The biggest fear is that it might unravel as quickly as it has unfolded. Much of the rise in housing prices is due to declining mortgage rates, Miller said, estimating that over three to five years, a house's value will climb between 12 percent and 20 percent when interest rates drop from 7 percent to 5 percent.

The fear is that real estate prices will fall when interest rates creep back up, Miller said, especially on the East and West coasts, where prices have been most volatile. Already, a new federal study found, the growth of house prices has slowed sharply over the past year. From the first quarter of 2002 through the first quarter of this year, average prices fell in 13 of 220 metropolitan areas surveyed by the Office of Federal Housing Enterprise Oversight. Average prices rose in the District, Maryland and Virginia.

Another concern is the refinancing boom has enticed Americans to pile up debt by taking on bigger mortgages.

And for all the benefits to long-term wealth of a low 30-year, fixed-rate mortgage, there are potential problems. For one thing, homeowners may be reluctant to switch jobs if it means taking on a higher mortgage rate, which could make the labor market less efficient, said Cutts of Freddie Mac.

"If [a mortgage rate] goes to 10 percent, somebody with a 6 percent rate looking at a new job in St. Louis might not take that job," she said.

At this point, most economists studying the issue are sanguine about such prospects. Interest rates surely will creep up, they say, but they won't shoot up. Thanks to the Federal Reserve Board, the days of raging inflation and 18 percent mortgages are behind us, economists say.

Not everyone is so confident. Brad Houser, a real estate broker and developer in Iowa City, has ridden the wave as avidly as anyone. In three years, he has refinanced three times, reducing his interest rate from 7.9 percent to 5.87 percent. A month ago, he walked away from his mortgage broker's office with a $100,000 cash-out check, which he promptly put to use to finish his basement and add a few extras to his house above-ground as well.

But he has concerns that the gravy train is coming to an end. His realty business could suffer, as people hunker down with their low-rate mortgages rather than look for new houses. For the next generation of homeowners, who will probably face higher mortgage rates, there will be a great divide, he predicts, "no question about it."

Facing higher rates, young buyers will settle for smaller homes and will need help from the generation locked in under 6 percent, Houser predicted.

He does not know when this will happen, but fretted that when the average rate rises, "it'll go up faster than it ever came down."

JUL 29 2003 15:55 FR MORTGAGE BANKERS ASSO TO 2022250659 P.02

The Premier Association of Real Estate Finance

Mortgage Bankers Association of America
1919 Pennsylvania Avenue, NW
Washington, DC 20006-3438
www.mbaa.org

TO: Congressman Rubén Hinojosa

FROM: John A. Courson, Chairman, Mortgage Bankers Association of America (MBA)

DATE: July 29, 2003

RE: Responses to follow-up questions from MBA's June 12, 2003, testimony on the reauthorization of the Fair Credit Reporting Act

---

PANEL 1

FOR EVERYONE ON THE PANEL

1. **Do you understand how FICO is developed, and do you know what factors (ingredients) are incorporated in the score?**

Answer: FICO scores or credit scores are produced by private corporations such as the Fair Isaac Corporation, Equifax, Experien and TransUnion. These scores are proprietary. Fair Isaac Corporation develops models that evaluate certain factors to produce a FICO score. Those factors are available for free to the public and include: payment history, amounts owed, length of credit history, new credit and types of credit used. How these factors are weighed and considered within the model is proprietary and therefore, not disclosed to mortgage lenders.

2. **If so, can you share that information?**

   What is your understanding of what you are allowed to do with the information contained in the credit report and, separately, of the score that you receive from the credit bureaus?

   Also, how much do you pay the major credit reporting agencies per report? Is it as much as the approximately $29 consumers would have to pay for both the credit report and credit score?

Answer: Mortgage lenders and credit reporting agencies (CRAs) enter into contracts for the sale of credit reports. Both parties negotiate the cost of the credit reports based on the volume required by the lender. Therefore, the cost per credit report varies between lenders.

The contracts between lenders and CRAs may contain provisions that prohibit the lender from disclosing the contents of the credit report, which would include the credit score. The Fair Credit Reporting Act requires that when a lender takes an adverse action against a consumer, the lender must provide a notice to the consumer including the name and the address of the CRA that supplied the credit report and a statement that the consumer is eligible for a free credit report from that CRA.

Lenders may notice discrepancies on credit reports. Lenders are generally not in a position to investigate or correct discrepancies on a credit report that are unrelated to the lender. In this situation, the lender recommends that the consumer contact the CRA for assistance since the CRA is in a better position to respond.

UNDER THE SECTION "FOR WELLS FARGO"
Request that all on panel 1 answer the question below.

4. **Do you currently provide all kinds of financial services in California? How would pending California law impact members of the Mortgage Bankers Association? How would it impact members of the Mortgage Bankers Association?**

Answer: Members of the Mortgage Bankers Association (MBA) certainly provide a variety of services to consumers in California and around the country. Affiliate sharing enables our members to offer innovative products to consumers cheaply. Further, consumers can take advantage of a wide range of products of which they may not have been aware.

If California law were adopted and required consumers to "opt-in" to affiliate sharing, the amount of available consumer information would greatly decrease, placing a significant obstacle to a consumer's awareness of new and innovative products. Further, the loss of business that industry would endure would invariably raise the cost of credit – a result that would be bad for consumers and the economy.

In addition, the MBA supports consideration of a national uniform privacy disclosure notice. Experts agree that current privacy notices should be simplified, shortened and standardized. Permitting states to pass disparate laws related to the form and content of disclosures could result in consumer confusion. Further, the cost of complying with fifty sets of laws would be exorbitant and likely increase the cost of credit.

5. Do you agree with Chairman Greenspan that all of the seven exceptions to the Fair Credit Reporting Act should be reauthorized this year? If so, why? If not, why not?

Answer: MBA agrees with Chairman Greenspan.

The Fair Credit Reporting Act (FCRA) plays an important role in our nation's successful mortgage market and high homeownership rate. FCRA creates a structure that produces reliable consumer information that is used to lower the cost of homeownership, offer the dream of homeownership to underserved markets, and produce innovative mortgage products. It is imperative to the continued rise of homeownership rates and to access to credit that Congress reauthorize the seven areas preempted in the FCRA in their current form and maintain the national uniform standard of credit reporting. The national uniform standard is important for consumers and the mortgage industry because it gives rise to the following circumstances:

- It enables Americans to move to new states and purchase homes with relative ease;
- Lenders are able to originate loans on a national level increasing competition, thereby lowering the cost of credit to consumers;
- Mortgage lenders underwrite loans using automated underwriting systems that provide a quick response to a mortgage application. Automated underwriting systems are facilitated by the national uniform standard of credit. Reprogramming these automated underwriting systems to comply with inconsistent and fragmented state laws will surely increase the cost of credit;
- A mortgage lender can take a successful program or product in one state and implement it in another state allowing those consumers to benefit from it, and
- Credit reports have become reliable measures of an applicant's willingness and ability to pay.

Consumers could loose out on taking advantage of the financial benefits FCRA creates if the seven areas preempted in FCRA are not reauthorized. MBA supports reauthorization to permit continued homeownership growth, which increases personal wealth and promotes a strong economy.

1. Do you understand how FICO is developed, and do you know what factors (ingredients) are incorporated in the score?

First, It's important to note that FICO is a company (Fair, Isaac), not a product. FICO, like TransUnion and many others, develops scoring models that are used by a variety of industries to predict the likelihood of a specific behavior. While these scores are often used by credit grantors to make fast, reliable decisions at the point of contact with a consumer, they are more frequently used as one component in a complex decision making process.

In response to your question, I will focus on scores developed for use by the credit industry

The credit industry uses various types of credit scores to assess risk for different types of credit. For example, a creditor may use one type of score when assessing risk for a credit card account, and another type of score when assessing risk for a mortgage account and still another to better predict bankruptcy risk, credit usage, tendency to respond to offers of credit, etc.

A credit score is an objective "snapshot" of the consumer, representing the consumer's creditworthiness as a number, which is calculated from information that may or may not be derived from a credit report on the day the score is output. For example, many credit scores use consumer financial information not contained in a credit report summary of that information, such as income history, total assets, and total liabilities. Numerical weights are placed on different aspects of the consumer's credit report or other relevant information and a mathematical formula or computation is used to arrive at a final score.

Federal regulations are in place to ensure the fair application of credit scores. One of the most important of these is Regulation B, which, among other things, requires that credit scores not discriminate based on categories such as race, gender, and age.

Credit Score Design *– Credit bureau scores are composed of characteristics, attributes and points resulting in a score. The score, usually three or four digits, is associated with specific performance outcome. For example, a score may predict the odds that an individual will go delinquent, or it may predict the amount an individual is likely to repay on a past due balance. A characteristic is a predictive element of a credit report, such as "number of delinquencies." An attribute is the value of a specific characteristic. For example, if an individual has four delinquencies on their file, the attribute for the characteristic "number of delinquencies" would be 4. Points are assigned based on the relative importance of the attribute in predicting a given outcome.*

How is a credit score calculated? *To calculate a score, numerical weights are placed on different aspects of a consumer's credit report and a mathematical formula is used to arrive at a final credit score. TransUnion calculates a credit score based on many factors of a consumer's credit history and payment behavior, including the public record, collection, tradeline, and inquiry sections of the credit report. These many factors may include, but are not limited to:*

- *How a consumer is paying their accounts*
- *How much money the consumer currently owes*
- *How long the consumer's accounts have been open*
- *What different types of credit the consumer uses*
- *How much credit the consumer uses compared to the amount of credit the consumer has available*
- *How often and how recently the consumer has applied for credit*

The development of a credit-based model can be done in various ways. In general, the process is as follows:

1. *Obtain a sample representative of the population that will be subjected to the model.*
2. *For the sample, calculate the known performance of the accounts.*
3. *Calculate the observation, or predictive, characteristics to be analyzed in the development of the model. These characteristics should reflect some time period prior to the performance of the accounts.*
4. *Using the mathematical or statistical methods of choice (ie, chi-square, ratios, information values, etc.), choose eligible variables for the development of the algorithm/score*
5. *Again, using the mathematical or statistical methods of choice (ie, linear regression, logistic regression, etc.) calculate the attributes and points most predictive of the outcome being predicted.*
6. *Apply the resulting model against a "holdout" population to ensure the model's ability to perform on a population different from the sample used for its development.*

Once the score has been developed, it should separate the "good" accounts from the "bad" ones. It should also exhibit rank-ordering, where an increase in the score represents a higher or lower likelihood of being good or bad. In general, the higher the score, the better the risk (meaning the higher the likelihood of being good).

How often does a credit score change? *Credit files continually update with new information from creditors. A credit score is calculated based on the information contained within a consumer's credit file at the time the credit score is calculated. Therefore, a credit score can change every time the information in a credit file changes.*

How do inquiries impact a credit score? *An inquiry is recorded on a credit report every time the consumer, one of his or her creditors, or a potential creditor obtains a copy of his or her credit report. A common misperception is that every inquiry decreases a consumer's credit score a certain number of points. This is not true. Typically, the presence of inquiries on a credit report has only a small impact on a credit score, while certain types of inquires have absolutely no impact on a credit score. The consumer's inquiries and prescreen inquiries never count in scores because they are not disclosed on credit reports; they are disclosed only the consumer. Inquiries generally have less importance than delinquencies, balances owed, and the length of time a consumer has used credit. Inquiries are usually more important on a credit score if a consumer has a limited credit history.*

How can a credit score improve? *Maintaining a good credit standing and continuing to exhibit responsible credit behavior are the best ways to ensure that consumers are presenting the most positive picture of their credit worthiness. Improving consumers' credit standing and their credit score is not a one-time-fix; they must change how they view and handle their credit over time.*

2. If so, with whom can you share the information?

In general, credit scoring models are customized, are treated confidentially and cannot be shared outside the boundaries of a customer / supplier relationship. As noted above, there are hundreds of credit scores used for many aspects of risk assessment. Each credit grantor that uses credit scoring has different risk tolerances, target customers, rating programs, tier placements, and places different weights on factors in a credit report.

What is your understanding of what you are allowed to do with the information contained in the credit report and, separately, of the score that you receive from the credit bureaus?

N/A

Also, how much do you pay the major credit reporting agencies per report? Is it as much as the approximately $29 consumers would have to pay for both the credit report and score?

In response to the second part of this question, TransUnion currently charges consumers no more than $12.75 for a TransUnion Personal Credit Report and Score.

4. Do you currently provide all kinds of financial services in California?

TransUnion provides credit reporting, account acquisition and management, collections, employment screening, ID verification and fraud detection, and risk management services in California.

California's law would make the Fair Credit Reporting Act requirements tougher, and some contend that California's law could eventually become the law of the land unless Congress takes action this year. Am I correct?

TransUnion has already adopted California law as national practice, where it has made sense to do so. Score disclosure and tradeline blocking with police reports are two examples. However, when California enacts laws we consider harmful to consumers, such as the requirement to match at least three elements of identification for retail point of sale transactions, we limit our implementation to comply with the law strictly within that state. An example of this is three-factor data matching. In our experience, the higher number of requirements for identity matching leads to fewer credit files being returned, with an especially disparate affect on persons who change address, such as new movers to the state and military personnel, as well as those who change their name, like newly married or divorced individuals. We are concerned that a national implementation of this rule would harm consumers.

In addition, the new California draft includes a provision that would let financial companies freely share customer data among corporate affiliates, as long as they have, and I quote, "the same functional regulator and are engaged in the same line of business." What is your opinion of that bill?

This bill would put more restrictions on affiliate sharing and thus restricts business, and in turn drive up costs for consumers. The free flow of information between corporate affiliates creates significant benefits for consumers, including services and products being provided at lower costs. A business that is able to share customers' preferences within its affiliated companies is better able to provide better customer service, better able to sell relevant products and services to the customer, and in turn better able to retain the customer. Shared information among affiliates allows consolidated account statements, customer loyalty programs, co-branded marketing services, and the convenience and efficiency of managing and updating information on a single system (for example, change of address). Businesses that utilize affiliate sharing can thus provide lower prices and better service to consumers.

In the California legislation, customers would have to be given the opportunity to block, or "opt out" of, transfers of confidential data to separately regulated affiliates or outside financial companies. In addition, customers would have to give explicit permission, an "opt-in," before their financial provider could share personal information with nonfinancial third parties. What is your opinion of this legislation?

See above. Also, note that the current version of California SB 1 exempts dataflows to and from consumer credit reporting agencies, as defined in California law.

How would it impact your organization if it became the national standard?

Since reporting information to and from consumer reporting agencies is currently exempted under SB 1, we see no direct impact. However, there could be indirect impacts since, as noted above, both consumers and many of our major business customers will be harmed by the restricted information flows. The reduced commercial, promotional activity of these companies operating in California will very likely impact TransUnion's provision of business services to them.

5. Do you agree with Chairman Greenspan that all of the seven exceptions to the Fair Credit Reporting Act should be reauthorized this year? If so, why? If not, why?

Yes, we agree with Chairman Greenspan that all seven preemptions to the FCRA should be reauthorized this year. The credit granting process, which relies heavily on the information and activities regulated by the FCRA, has resulted in more choice and convenience to consumers at lower costs. If preemption were to expire and each state were allowed to create and implement its own credit reporting laws, our nation's credit reporting system would be severely fragmented and the consequences to consumers and our economy would be significant. Additionally, we believe these preemptions should be expanded to include the improvements to be made to the FCRA through legislation to be adopted by Congress this year.

Predictive Power of Consumer Reports

A consumer report represents a complete, accurate, and up-to-date snapshot of a consumer's financial history. This is important to a lender assessing a consumer's credit risk for several reasons. First, the lender can evaluate the information provided in a consumer report and make a credit decision accordingly. Just as importantly, a lender reviewing a consumer report has a high degree of confidence that the consumer report includes a complete picture of the consumer's financial history. In other words, the lender knows that he or she has a complete understanding of the consumer's financial history and that there is not any material information about the consumer's creditworthiness being hidden. The fact that the consumer report is complete, accurate, and up-to-date allows the lender to make an accurate assessment of the consumer's credit risk. The widespread availability of credit in the US supports that the system works, and works substantively all the time.

Furnisher Obligations *– The ability of a lender to rely on a consumer report when making credit decisions is preserved, at least in part, through several provisions that establish the FCRA as the national, uniform standard. For example, furnishing information to credit bureaus is completely voluntary. Creditors and others are willing to provide information to credit bureaus because they understand the value of, and benefit from, a robust credit reporting system. Despite the obvious interest most furnishers have to report only accurate and complete information, in 1996 Congress determined that those who furnish information to credit bureaus must have some legal obligations with respect to the accuracy and completeness of information provided to credit bureaus. However, in imposing these obligations, Congress recognized that the data provided to credit bureaus was the lifeblood of the credit reporting and underwriting processes. Therefore, the furnisher obligations represent a careful balancing of the need for accuracy with the need to ensure an uninterrupted flow of information to credit bureaus. The compromise reached in the 1996 amendments, imposing accuracy and completeness obligations on furnishers, enforceable by state and federal agencies, establishes a national standard under the FCRA.*

If states were permitted to impose additional obligations or liabilities on furnishers, the viability of the credit reporting process could be threatened. We believe that various state laws with respect to furnisher obligations may discourage entities from providing information to credit bureaus. Indeed, depending on the state law, it may be prudent for furnishers not to provide such information if it would subject the furnisher to unnecessary litigation, including class action liability. If this were to happen, consumer reports would contain less information and become less reliable. In effect, lenders would no longer have confidence that a consumer report represents a complete, accurate, and up-to-date snapshot of the consumer's financial history. In order to *compensate for this uncertainty when evaluating the consumer's creditworthiness, lenders may be less willing to provide credit to the consumer, or may do so only at an increased cost.*

Contents of Consumer Reports – *Just as lenders know that a consumer report is complete because a large number of furnishers provide significant amounts of information, they also know that a consumer report is complete as a result of the uniformity established under the FCRA. The FCRA generally does not allow a consumer reporting agency to report "obsolete" information as part of a consumer report. Obsolete information includes most negative information that is more than seven years old, and bankruptcies that are more than ten years old. The FCRA preempts state law with respect to the contents of consumer reports.*

Lenders would have less confidence in consumer reports if a state were permitted to limit the information contained in a consumer report. For example, if a consumer report could only include negative information that is less than four years old, it would be less predictive of a consumer's credit risk than a consumer report that had information dating back to seven years. Furthermore, if a state were permitted to restrict the types of information included in a consumer report (e.g. prohibiting the reporting of 30-day payment delinquencies), a lender could be denied important information necessary to evaluate the consumer's credit risk. Again, creditors would respond to this uncertainty either by making less credit available to consumers, or by increasing the cost of credit.

Reinvestigation Timeframes – *Among the many rights provided to consumers under the FCRA is the right to challenge the accuracy of consumer report information. We believe this is an important consumer right and it can be useful in making our files more accurate. The FCRA establishes a 30-day timeframe under which a consumer reporting agency must reinvestigate a consumer dispute. If the consumer reporting agency finds that the information is inaccurate, or cannot verify its accuracy within the 30-day period, the information must be deleted. This timeframe is uniform throughout the country. This uniformity is important if consumer report information is to maintain its current level of reliability. If states were permitted to establish differing reinvestigation timeframes, consumer reporting agencies may not have sufficient time for file reverification, and national data furnishers would be overwhelmed in complying with the differing reinvestigation turnaround times — creating another incentive to withdraw from full-file voluntary reporting.*

Technology offers one solution to speeding reinvestigation times. The 1996 amendments required the national consumer reporting agencies to adopt an automated system for communicating consumer requests for reverification to data furnishers and to the other national agencies. This system (ACDV) has now been in existence for over five years, and 52% of our data furnishers participate in it. Our goal is 100% participation. Turnaround time for these inquiries is 50% faster, on average, than on the old manual system still in operation. Aside from the detrimental impact on the accuracy and completeness of consumer reports, we are also concerned that such state laws would unintentionally open the door for fraudulent "credit repair" clinics to attempt to overwhelm credit bureaus with reinvestigation requests with the hope that the consumer reporting agency will not have the resources to complete all of the investigations within the shorter timeframe established by the state. We estimate that 35% of our reverification volume comes from credit repair clinics. Our experience is that these clinics cost consumers thousands of dollars, clog the dispute process for all consumers and rarely result in any material change to the consumer's credit report.

<u>Consumer Notice</u>

In order for the consumer reporting process to work well, consumers must know what their rights are under the FCRA. Furthermore, each consumer must have the ability to learn about the contents of his or her consumer report, how to be more "creditwise," and how to verify the accuracy of their credit report. Just as importantly, each consumer should be made aware when *information in his or her consumer report results in a denial of credit. There are several provisions in the FCRA that establish a national uniform standard with respect to consumer notice.*

Consumer Disclosures *– The FCRA requires a consumer reporting agency to provide a consumer with a summary of his or her rights under the FCRA with each written disclosure of a consumer report to the consumer. The Federal Trade Commission has provided consumer reporting agencies with model language that can be used to comply with this important requirement. The form and content of this disclosure is uniform across the country under the FCRA.*

We believe that this uniform standard is important if consumer reporting agencies are to provide meaningful disclosures to consumers about their rights under the FCRA. Under current law, consumer reporting agencies can provide clear and succinct disclosures to consumers regarding their rights. We do not believe states should be permitted to adjust the form and content of the notices describing the consumer's rights under federal law.
Furthermore, if states begin to deviate from the Federal Trade Commission's model, the disclosures likely would become more complicated for consumers. For example, the consumer may have an address on file in several different states, forcing the consumer reporting agency to provide several different disclosures to the consumer. This may result in confusion to the consumer. Alternatively, the sheer amount of verbiage in the multiple disclosures may discourage *the consumer from reading any of the important information.*

Voluntary Efforts *– In addition to our compliance with the FCRA's consumer disclosure requirements, we have established specialized staff and procedures in our Consumer Relations department to assist identity theft victims — which include individual consumers and our customers — to recover from identity fraud and prevention of future victimization. We also voluntarily provide a credit score disclosure for a nominal fee to consumers who request one. Today, through our web site www.transunion.com and the web sites of our affiliated companies we provide information on consumer rights, credit scoring, identity theft, opting out of prescreened and direct marketing offers, and managing credit.*

TransUnion's ability to provide useful and consistent consumer education is preserved, at least to some degree, by the provisions in the FCRA that establish national standards. Millions of Americans move to different states each year. Millions of others maintain residences or office addresses in more than one state. Many of these consumers maintain credit relationships associated with each of these addresses. The fragmentation of rights, policies, and procedures in these areas which would result from differing state laws would increase the complexity of the system and diminish, not enhance, most consumers' understanding of their rights and their ability to secure them.

Consider the person who has recently moved, or maintains addresses in different jurisdictions. If states were permitted to alter key provisions in the FCRA, such as reinvestigation timeframes or the contents of a consumer report, TransUnion would have a very difficult time providing the consumer with the appropriate notice regarding his or her rights as they pertain to the credit reporting process. Uniformity is vital if people are to understand the rules of the game. For the national consumer reporting agencies to fulfill their educational and empowering role in explaining consumer rights and the operation of the credit reporting system, it is critical that the system indeed be national and uniform.

Adverse Action Notices *– The credit granting process provides another mechanism for a consumer to be informed of his or her rights. Each consumer who is denied credit due to information contained in his or her consumer report must receive an "adverse action" notice under the FCRA. Adverse action notices inform the consumer of, among other things: (i) the consumer reporting agency that provided the consumer report to the creditor; (ii) information on how to contact that consumer reporting agency; and (iii) the fact that the consumer may obtain a free* *copy of his or her consumer report from that consumer reporting agency and may request a reverification of any inaccurate or incomplete information contained in the report. These adverse action responsibilities are uniform throughout the country, and serve as an important tool in notifying consumers of potential errors in their consumer report.*

It is important to maintain the national uniformity with respect to adverse action requirements for the same reasons discussed above pertaining to the disclosure requirements imposed on consumer reporting agencies. If consumers are to receive a meaningful disclosure, it must be succinct and uniform throughout the country. Additional requirements imposed by a state would simply dilute the important information conveyed in adverse action notices.

Improved Underwriting Process

***Prescreening** – Prescreening is a process by which a creditor (or an insurer) provides a firm offer of credit (or insurance) to consumers who meet the eligibility standards for the prescreened credit (or insurance). For example, a creditor may obtain from a credit reporting agency a list of consumers who meet certain prespecified underwriting criteria. The creditor must make a firm offer of credit to each consumer on the list and provide credit to each consumer who responds, assuming the consumer continues to meet the terms of the offer. There is no question that prescreening has allowed creditors to compete for consumers across the country, which has reduced the cost of credit and increased the credit choices available to consumers. However, prescreening also serves as an important tool for creditors in their efforts to manage their portfolios. By specifically targeting consumers that meet certain lending criteria, creditors are better able to control their credit risks. Indeed, we understand that losses associated with accounts obtained through prescreening are generally less than losses associated with accounts obtained through other means.*

***Affiliate Sharing** – The ability of affiliates to share information among themselves can be an important component of a creditor managing the credit risk of its portfolio. Not surprisingly, the value of affiliate sharing in the underwriting context has been noted by the federal banking agencies. The agencies, in draft guidance that was released to those in the lending community, recommended that financial institutions use affiliate sharing to better monitor consumer activity across business lines in order to prevent an over-extension of credit to individual consumers. In this regard, affiliate sharing helps creditors operate in a safe and sound manner and reduce chargeoffs. The end result is the opportunity for lower costs to consumers.*

The Importance of Nationally Uniform FCRA Provisions In Identity Theft Prevention and Resolution

***Furnisher Obligations** – As discussed above, state laws pertaining to furnisher obligations may reduce the number of entities willing to provide information to consumer reporting agencies. Withdrawal of data furnishers from the system will result not only in a loss of the credit information they provide but will also result in the loss of the address updates they provide.*

TransUnion's database relies on addresses that are in active use by creditors in mailing monthly statements to their customers. The fact that most data furnishers today also provide us with the social security number of their customers allows us to bridge address changes and name variations. Businesses and government agencies with a permissible purpose to obtain a consumer report rely on our robust national database of names and up to date addresses for a variety of fraud prevention and identity authentication services.

If there is less current identification or address information coming into the database, the performance of these services will suffer.

***Reinvestigation Timeframes** – Consumer reporting agencies play an important role as part of the solution to identity theft. In essence, the consumer reporting agency is tasked with sorting out accurate information about the consumer, and maintaining it, while deleting any information from* *the credit file that may be the result of an identity theft. We at TransUnion believe that the national 30-day reinvestigation timeframe allows us the opportunity to establish a single reinvestigation process that treats all consumers fairly. As the Subcommittee knows, reports of identity theft are on the rise. TransUnion works closely with consumers to resolve these claims. However, these claims can be complex and require significant resources. We believe it is difficult enough to resolve these reverifications correctly under the system permitted by a single federal law. The difficulty in correctly resolving identity theft claims if we had to operate under systems established by dozens of state laws would be even more difficult.*

***Prescreening** – In addition to providing creditors with the opportunity to manage their credit risk, prescreening also gives creditors the ability to better manage their fraud risk, including fraud as a result of identity theft. We understand that fraud associated with prescreened applications is much less than fraud associated with accounts acquired through other means. Indeed, a witness from a prior hearing noted that their fraud losses associated with prescreened accounts are one-seventh the fraud losses associated with accounts obtained through other means.*

***Affiliate Sharing** – It is our understanding that creditors are making more use of information obtained through affiliate sharing to complement the consumer reports they obtain from consumer reporting agencies in order to prevent identity theft. For example, a creditor may detect a possible case of identity theft if that creditor detects a discrepancy between information on the credit application and information maintained by an affiliate with the same individual (e.g. the social security number does not match up).*

1. Do the seven exceptions to the Fair Credit Reporting Act due to expire January 1, 2004 promote accuracy, and if so, how?

All of the above answers on uniformity, national standards for data furnishers, etc. support the argument that national standards promote accuracy.

2. Do credit bureaus compete on accuracy?

Yes. Accuracy is how credit bureaus make a living and how we compete in the marketplace. Quality of credit reports is very important. It takes a wide base of fresh and accurate information to derive reliable information about applicants. Credit reports derived from a wide base of business, agency, and public entity data are more accurate and more likely to achieve our business customers' goals. Credit bureau solutions include analytic measures and models that get to the core of customer information needs - from monitoring accounts and setting risk thresholds, to screening prospective employees and predicting and averting fraud. Our products, models, and segmentation tools cover the life cycle of consumer credit, providing customers with total business solutions. Thus, it is our best interest, and both our business and consumer customers, to have the most accurate information available.

If so, how can that be done unless they know the content of each other's internal methodology for determining credit scores and issuing reports?

As the national standard for ensuring accuracy, the FCRA provides the framework for accuracy for all the credit bureaus: relevance of information; duties of data furnishers; notice to furnishers and users; duties and periods of reinvestigation, amongst others. We do not need to know the inner workings and processes of our competitors to compete when we have a national standard that promotes accuracy of information. Most businesses do not know the internal workings and processes of their competition yet compete nonetheless.

Furthermore, our customers know, and compare, the quality and accuracy of the reports provided by the three national agencies.

3. Does TransUnion provide Spanish-language consumer disclosures and consumer assistance live personnel?

Yes, upon request via mail or phone, TransUnion provides Spanish-language consumer disclosures. We also provide, upon request, live Spanish-speaking Consumer Relations staff to assist consumers. In fact through our AT&T Language Line interpretation service, we are able to assist consumers in 27 different languages. For hearing impaired consumers we offer TDD support.

4. I have a three-part question: Would you oppose such a requirement [providing a free credit report annually upon request]?

Yes, TransUnion would oppose providing free credit reports to all consumers each year. We unequivocally support a consumer's right of access to his or her file and current regulations on free reports in the FCRA strikes an appropriate balance. Consumers can obtain a free report if they certify in writing that they are unemployed but seeking employment, receiving public assistance, or believe they are a victim of fraud. Additionally, if consumers have been denied credit by a lender, the lender is required by law to identify the consumer reporting agency that provided the report on which they based their decision. Consumers are entitled to a free copy of their report within 60 days of the denial.

A consumer may obtain a copy of his or her entire file from a consumer reporting agency at any time. For consumer not eligible for a free report, the report must be provided at a low cost capped by the FCRA (at time of enactment, $8.00, currently, based upon CPI indexing, $9.00). The agency must include in such a disclosure a summary of the extensive consumer's rights under the FCRA.

Additionally, we oppose giving annual free reports for the following reasons:

***Consumer service levels will suffer under an annual free disclosure requirement** – We average 5 years of employee experience within our consumer relations operations. Consumer relations' staffs are trained in compliance procedures relative to the Fair Credit Reporting Act and to work with literally millions of consumers per year. Free disclosures requests will not be distributed evenly on a month-by-month basis. There will be incredible spikes in activity where a breach of security occurs or media coverage of some sort results in additional consumer disclosure requests because of concerns by consumers. We are also extremely concerned about how we will be able to predict call volumes and ensure timely responses to what may be millions of new consumers since we cannot draw on traditional sources of third-party call centers due to the nature and sensitivity of the data involved.*

To draw from a current real-world example of how risks can exist at the national level, the three national consumer reporting agencies operate a nationwide toll free number by which consumers may opt out of prescreened (direct mail) offers of credit. This is a requirement of the current federal FCRA. Each year for the last three years an e-mail circulates widely across the country that makes a false assertion about a law. The FTC publishes a consumer warning each year regarding this e-mail. This false e-mail suggests that consumers should call the nationwide consumer reporting agencies toll free number and the thus the activity levels for the toll free number quadruple for a period of time that extends for as much as two full months. This example shows just how exposed our industry is to a nationwide free annual disclosure requirement which will have unintended consequences.

***Data security breaches by other companies put nationwide consumer reporting agencies at risk** – Security breach notices which are already required in CA law will drive up the number of notices consumers receive and these notices very commonly contain a recommendation that the* *consumer contact all of the nationwide consumer reporting agencies to order copies of their file disclosures. Consider the following estimate of risk based on just a few public security breaches:*

- *Scenario – The combined total of the number of consumers affected by the security breaches of TriWest (750,000), University of Texas (50,000), CA State Employee Database (200,000), and DPI (8,000,000) is approximately 9 million. If each affected consumer receives a notice that recommends contacting all nationwide consumer reporting agencies to request free credit reports then the costs of servicing even 75% of these affected consumers could be $67.5 million per national credit reporting company or more (9 million X .75 = 6.75 million X $10 = $67.5 million) on top of the regular free disclosure activity that may occur in any given year.*

Costs would increase for companies and consumers – *Free files will create significant incremental costs for TransUnion. At this point, it is difficult to determine the exact cost of providing free credit reports. Our only similar experience has been in Colorado, where they have a free report statute and annual notice requirement. However, based on that experience, we conservatively estimate that our consumer relations' volume will increase five-fold.*

If the requirement were implemented, who would pay for it?

TransUnion has always supported consumers' access to their personal credit information and we recognize that consumer access will lead to a more informed consumer population and eventually a stronger economy. But the cost to provide every American consumer a free report is enormous and would ultimately be paid for by the consumer. If mandated, the free credit report provision is expected to have a significant impact on our customers' businesses, as we anticipate credit report costs to increase. For example, if the small business owner / mortgage broker today bought credit reports from us at, say $5 per report, and our consumer relations costs increased fivefold as suspected, then we will have to increase the cost of each credit report that mortgage broker purchases from us to recoup our costs. For the mortgage company to recoup their increased costs of running a credit report, they will pass this cost on to their customers, U.S. consumers.

How much would it cost you to provide one free credit report per year to consumers using the average number of credit report requests from consumers annually as a reference?

As we stated, free files will create significant incremental costs for TransUnion. At this point, it is difficult to determine the exact cost of providing free credit reports. Unexpected spikes in call volumes are hard to anticipate and have not been included in our estimates. E-mail campaigns, nationwide media coverage, and security breaches at large governmental or private sector organizations are sure to induce surges in volume to our systems that will be extremely difficult to manage. Additionally, cost is only one component to consider. The time to provide the free reports will have an impact on our ability to service protected classes – ID theft victims, consumers on public assistance, unemployed consumers, et al. – as the law does not distinguish between these persons and the general population. In 2003 we will spend $63 million to provide 8 million file disclosures to consumers. We expect a five-fold increase in the number of disclosures to result in a roughly proportionate cost increase.

The average cost for a disclosure, factoring in consumer requests for reverification relative to file disclosed, is $10. TransUnion disclosed over 5.2 million free disclosures in 2002 under current law. Consider the following scenarios relative to a free file disclosure requirement imposed on nationwide consumer reporting agencies:

- *Scenario 1 – We disclosed over 5.2 million free reports in 2002 based on the requirements of current law, and if that figure were to increase five-fold (as we conservatively estimate), then* *the incremental cost increase would be $260 million. (5.2 million disclosures x 5 = 26 million free disclosures / year x $10 = $260 million)*

- *Scenario 2 – If only 10% of our entire file base orders free file disclosures then the incremental cost of providing this disclosure relative to the 15.6 million files would be $156 million. (200 million files x .10 = 20 million disclosures – 5.2 million current disclosures = 15.6 million additional disclosures per year x $10 = $156 million)*

- *Scenario 3 – If a highly publicized event or misinformation drove 25% of our file base to order a free file disclosure then the incremental costs would be $420 million. (200 million x .25 = 50 million files – 5.2 million in current free file disclosures = 44.8 million new free disclosures x $10 = $420 million)*

In addition, according to the Congressional Research Service report for Congress titled "A Consumer's Access to a Free Credit Report: A Legal and Economic Analysis" cost to each nationwide credit reporting company could be anywhere from $83 million to $1.9 billion. We feel these are reasonable estimates based on our educated guess at a five-fold increase in consumer relations activities but there is serious risk involved for our industry if free, annual disclosures are required.

Honorable Ruben Hinojosa's FCRA Hearing Follow-Up Questions to America's Community Bankers

Free Credit Reports

ACB believes that the continued integrity of the national credit reporting system demands that credit reports be as accurate as possible and that consumers should be empowered to proactively manage their credit information. That is why ACB supports providing all consumers with access to a free annual credit report. Such access is already available to citizens of New Jersey, Colorado, Georgia, Maryland, Massachusetts and Vermont.

In addition to ensuring the accuracy of credit report data, providing greater access to credit reports can also help identify cases of identity theft earlier. The sooner identity theft victims are able to report fraudulent activity on their credit report, the greater the likelihood that law enforcement can track down these criminals and the financial services industry can minimize loss.

ACB acknowledges that these consumer empowerment tools come with a cost that will eventually be distributed among all parties in the credit granting process. Nonetheless, ACB believes these costs will be outweighed by the benefits provided from a more accurate national credit reporting system, increased consumer trust in the integrity of the system, and an effective way to combat financial crimes.

FICO Scores

ACB supports legislation to provide consumers with greater access to credit scores, information on how a credit score is derived, and how their credit score may be improved. Credit scores allow lenders to effectively assess risk and provide consumers with the ability to get credit from a lender with whom they have no existing relationship. Although credit scores are an important element in many lenders credit decision process, it is not the only factor. Community banks consider other factors such as employment history, debt-to-income ratio, and credit history. When all the factors are considered, lenders may extend credit to an individual who has a low credit score, or decline credit to a consumer with a high credit score.

Community banks understand generally the elements that go into making a credit score, however, the actual mathematical formula used to determine an individual credit score is proprietary information licensed by the producer of the score. While credit bureau scores are often referred to as "FICO" scores, each major credit bureau uses their own scoring model developed by the Fair Isaac Corporation that utilizes only the data available at that agency. As such, credit scores will vary at each credit bureau. On their Internet site, Fair Isaac Corporation (www.myfico.com) provides extensive and easy-to-understand information on how credit scores are developed, what factors affect a credit score, and what steps consumers can take to improve their score.

Honorable Ruben Hinojosa's FCRA Hearing Follow-Up Questions to America's Community Bankers

of Credit Reports

The Fair Credit Reporting Act (FCRA) restricts the sharing of credit reports, and mor generally any information "bearing on a consumer's credit worthiness," with any thir party. Any entity that shares such information risks being considered a "consumer reporting agency" and subject to the extensive FCRA legal requirements that would o be acceptable by a business entity solely focused on credit reporting. Users of credit reports may share information with corporate affiliates only after providing consumer with the right to opt-out of such information sharing.

The fee a community bank pays for obtaining credit reports from the major credit reporting agencies vary widely based on the volume, type of access, and provider use Federal law (Real Estate Settlement Procedures Act) requires for mortgage loans the disclosure of actual fees paid for credit reports and prohibits the assessment of any unearned fees.

Wells Fargo's Responses to Questions Submitted in Writing, following Wells Fargo's testimony on June 16, 2003; David Moskowitz, testifying.

Do you understand how FICO is developed, and do you know what factors (ingredients) are incorporated into the score?

- Consumers as a group ought to be better informed about their credit reports including so-called FICO scores. Although we do not know the exact formulas used in the FICO scores, we – and regulators and the public generally – do know the types of information considered by those scores. Given the types of information considered – which do not include any of the "prohibited bases" under ECOA or FHA – it is unlikely that these scores could be discriminatory. In addition, Fair Isaac, the developer of the FICO scores has published studies indicating these scores are not discriminatory, and those results have been confirmed by separate studies conducted by the credit bureaus and the GSEs.

You indicate in your testimony that a fair number of referrals are made from a Wells Fargo bank to the mortgage company. There is an assumption that such a referral is a proactive step towards bringing the borrower closer to obtaining a mortgage and to homeownership, the American dream. Wouldn't this be true for first-time homebuyers and for channeling people into mainstream financial services?

- Wells Fargo would believe that your statement is true. It is Wells Fargo's business strategy to serve as a one-stop financial services provider. Wells Fargo's goal is to provide one service in hopes that the customer will also use Wells Fargo for other purposes, e.g. student loans, small business loans, investment advice. Wells Fargo focuses its attention on the customer as a relationship and not simply a one-time transaction. In turn, customers do not care what governance structure the company uses in order to provide products and services.

My understanding is that at closing, borrowers are required to have homeowners insurance. It is also my understanding that Wells Fargo offers such insurance. If Congress were to impose restrictions on affiliate sharing, what impact would that have on Wells Fargo's ability to provide such insurance as compared to another unrelated insurance company offering homeowners insurance?

- Wells Fargo's experiences in North Dakota would suggest that consumers will not see the same variety of products that Wells Fargo customers receive in other states. Conforming to Gramm/Leach/Bliley, the North Dakota legislature changed its optin law to optout with respect to information sharing with outside third parties for financial purposes. But this was reversed by a 2002 referendum election to return to an optin standard – requiring banks to get customer approval before providing financial services offered by a third party financial services company. Wells Fargo expects that the result will have an impact on North Dakota's rural communities. To ensure compliance, Wells Fargo has, in effect, placed all the residents of North Dakota on a do not contact list regarding insurance products and is not providing any unsolicited information. Customers have opportunities for broad array of financial products and North Dakota's state action has the result of preventing rural access to that product list.

Given Wells Fargo's corporate structure, what would different state laws do to your ability to provide seamless service and the packaged products that you mention in your testimony?

- Our ability to compete against other companies - "our secret sauce" - is to be able to find credit worthy customers in a population that would not appear credit worthy just on credit bureau/credit score information alone - i.e. our own experience with the customer. For example, many small business customers use Wells Fargo's quick and inexpensive small business loan product, offered through Wells Fargo's business direct. Generally, these customers no longer have to submit tax returns or financial statements as Wells Fargo has reviewed their overall history with Wells Fargo.

- This allows us to qualify more customers and to extend credit to those we otherwise in the absence of this internal information would have turned down.

- If we can't aggregate our own customer experience info, our ability to identify good customers based on internally generated information would be eliminated. Competitors who collect information about customers and operate in a single enterprise would not be impacted.

- If each state were to set their own privacy notice and optout requirements, this would be very confusing for the customer. Wells Fargo provides banking services in 23 states and customers expect to conduct transactions if they move or travel from one Wells Fargo banking state to another. 35% of Wells Fargo customers have an address change annually – some of that percentage is comprised of customers that travel to new states and expect to have the same level of service from Wells Fargo when they settle in their new location.

What kinds of services do you currently provide in California? What would be the impact of pending California legislation on Wells Fargo? Would you want that as a national standard?

- It is unclear how the debate over the California legislation will conclude. Wells Fargo businesses and service would suffer if a state were to restrict affiliate sharing or require prior consent before we can even use our own transactional information would be significant change and detriment to Wells Fargo. Wells Fargo would like serve as a one-stop financial services provider. This does not preclude individuals from obtaining select financial products from a variety of financial services providers if they so choose. The proliferation of proposals to restrict sharing of identifying and transaction and experience information is the primary reason why extending FCRA's preemption of state laws restricting sharing of information among affiliates is so important to the financial services industry.

- Wells Fargo's customers expect seamless service across business lines. An opt-in would bring that service to a halt. As I mentioned in my testimony, new homeowners and small business owners have access to credit available to them as a result of our analysis of data. Customers receiving such offers are not bound, tied to accepting those offers. Wells Fargo is a financial services provider and should be allowed to structure itself in a way that allows the company to offer financial products to its customers.

- Equally as troubling to Wells Fargo is the prospect of California or other states mandating an additional privacy disclosure notice – over and above what is already required by Gramm/Leach/Bliley. If there is a problem with consumer privacy notices, it is that they are too long and too complex. Virtually all the experts in this area agree that privacy notices should be shortened, simplified and standardized (to enhance comparability). For many – perhaps most – financial institutions it would be extremely cumbersome and expensive to maintain and distribute 50 different notices (even small, local institutions are likely to have some customers who reside in different states). Thus the likely response to different requirements in different states would be an attempt to develop "one size fits all" notices that would meet the requirements of all the states, and which would be neither short nor simple.

Do you agree with Chairman Greenspan that all of the seven exceptions to the Fair Credit Reporting Act should be reauthorized this year? If so, why? If not, why not?

- The United States currently enjoys historically low interest rates on almost all credit products, and greater access to credit for all economic segments than has ever been true in the past. While the Fed's monetary policy due to the economic slump has been a factor, the decline in consumer interest rates began long before the economic downturn. Interest rates in the US are also lower than in almost any other country on earth. Long-term, the decline in consumer interest rates in the US has been driven by three primary factors:

- Better risk assessment;
- National competition; and
- An active and efficient secondary market for consumer credit receivables.

All three of these forces depend on accurate, complete and consistent credit information on a nationwide basis, and thus would be endangered if different states had different laws on information sharing and credit reporting and if the expiring Fair Credit Reporting Act provisions were allowed to lapse at the end of 2003. Wells Fargo recommends that Congress renew the FCRA provisions.

National Association of Mortgage Brokers

Response to Questions Posed by

Congressman Rubén Hinojosa

House Financial Services Committee

Subcommittee on Financial Institutions

"The Role of FCRA in the Credit Granting Process"

August 1, 2003

1. Do you understand how FICO is developed, and do you know what factors (ingredients) are incorporated in the score?

Fair Isaac developed the statistically based credit risk evaluation systems, referred to as the "credit scoring systems." Scoring models are statistical models that assign points to various factors that have been determined through the analysis of hundreds of thousands of loans to determine the risk of repayment of the consumer's debt. Credit scores are based on data stored in a consumer's credit file. A visit to Fair Isaac's website www.fairisaac.com or www.myFICO.com will provide a consumer with a wealth of information on Fair Isaac and their development of credit scoring models. NAMB has created educational brochures, in both Spanish and English, to assist consumers in a better understanding of credit scores, the role they play in the mortgage process, and the impact credit scores can have on the ability for a consumer to purchase a home.

Some of the factors that are considered by the scoring model at the time the credit report is requested are:

1. Past payment performance contribute to the consumer's credit score. The more recent a negative entry to a consumer's credit file the lower he or she will score in this category.
2. Credit utilization contributes to the consumer's credit score. A consumer who uses credit conservatively, keeping their balances at or below 30% of his or

National Association of Mortgage Brokers
Response to Questions Posed by
Congressman Rubén Hinojosa
House Financial Services Committee
Subcommittee on Financial Institutions
"The Role of FCRA in the Credit Granting Process"
August 1, 2003
Page 2

her available limit on a specific account, will score higher than a consumer who has reached the maximum limit available on their credit cards.

3. Credit history or the length of time a consumer has had accounts open contributes to the consumer's credit score. The longer credit has been established, the longer the scoring models have to observe how well a consumer manages his or her credit.
4. The types of credit a consumer has disclosed in his or her credit files contributes to the consumer's credit score.
5. The number of inquiries also contributes to a consumer's credit score, but there are some exceptions to this general rule. Fair Isaac also installed a buffer in the scoring models so that when a mortgage lender pulls a credit report, all mortgage or auto inquiries are buffered out of any impact to the consumer's score. Thus the consumer can shop for the best home loan financing without worry that his or her score will be lowered.

2. If so, with whom can you share this information? I want to clarify by asking:

What is your understanding of what you are allowed to do with the information contained in the credit report and, separately, of the score that you receive from the credit bureaus?

The end user must use the credit information gathered from the credit report exclusively for the granting of a mortgage loan. The information can be shared with no one other than the underwriter for the lender providing the loan. The originator is prohibited by the Fair Credit Reporting Act (FCRA) and its contract with the credit reseller providing him or her with that credit report from disclosing specific information to a consumer about what is in his or her credit file, unless the application for credit as submitted is being declined. If a consumer is denied credit, the creditor must issue an adverse action notice when the denial is "based in whole or in part on any information contained in a consumer report."

National Association of Mortgage Brokers
Response to Questions Posed by
Congressman Rubén Hinojosa
House Financial Services Committee
Subcommittee on Financial Institutions
"The Role of FCRA in the Credit Granting Process"
August 1, 2003
Page 3

Also, how much do you pay the major credit reporting agencies per report? Is it as much as the approximately $29 consumers would have to pay for both the credit report and score?

Credit report prices vary by the type of the report requested and from region to region, just like any other market driven priced commodity. Further, these prices are set by the credit repositories providing the reports. Generally, as of the current date, single credit reports from single repositories can run from $8.00 to $15.00, depending on if the consumer requests that their credit score be included in their credit report. Typically, most lenders use a tri-merged credit report which includes the raw credit data stored about that consumer in each of the three major repositories with the credit score and four reason codes attached. A tri-merged report generally runs somewhere between $18.00 and $40.00 depending the area's market price.

I am asking this question because panelists last week did not do a very good job of explaining FICO, its content, its origin, who regulates it, why consumers don't have ready access to its content, and the actual cost of the scores and reports prior to being. In fact, the hearing left me with the impression that Congress might need to take action to ensure that it has proper oversight of FICO's content.

I would like to allay my concerns because I represent a District with a significant number of Hispanics, and I want to ensure that FICO does not discriminate against them and that my constituents are not being overcharged for credit reports or scores. Last week, the Federal Reserve's witness was unable to respond adequately to the discrimination question.

3. **If I am correct, California has one of the most stringent FCRA laws. It also has legislation that was introduced quite come time ago but was recently modified by the Assembly. It is my understanding that the recent modifications to the bill would loosen previous restrictions on the sharing of information with affiliates, but it would still be tougher than the federal requirements. I want to note that Texas' restrictions are as tough as the current federal requirements, with a carve out for our usual**

National Association of Mortgage Brokers
Response to Questions Posed by
Congressman Rubén Hinojosa
House Financial Services Committee
Subcommittee on Financial Institutions
"The Role of FCRA in the Credit Granting Process"
August 1, 2003
Page 4

focus on arbitration instead of litigation. California's law w ›uld make the Fair Credit Reporting Act requirements tougher, and sor ıe contend that California's law could eventually become the law of the l ınd unless Congress takes action this year. Am I correct?

In addition, the new California draft includes a provision tha would let financial companies freely share customer data among corporate affiliates, as long as they have, and I quote, "the same functional regulator and are engaged in the same line of business." Wł at is your opinion of that bill?

In the California legislation, customers would have to be given the opportunity to block, or "opt out" of, transfers of confident al data to separately regulated affiliates or outside financial companies. I addition, customers would have to give explicit permission, an "opt-i ı," before their financial provider could share personal informa ion with nonfinancial third parties.

What is your opinion of this legislation?

How would it impact your organization if it became a national s andard?

NAMB does not typically take positions on state legislation. NAMI continues to review legislation as it moves through Congress to determine i ; potential impact on its members and will provide its input on such Federal le; islation as appropriate.

4. **Do you agree with Chairman Greenspan that all of the seven ex eptions to the Fair Credit Reporting Act should be reauthorized this ye: r? If so, why? If not, why not?**

NAMB generally supports the extension of the preemption rovisions contained in FCRA. If Congress allows the preemption provisions i FCRA to expire, the outcome of such inaction will have a detrimental e fect on a consumer's access to and availability of credit. NAMB believes tha failure to extend the preemption provisions will increase risks for mortgage c iginators, which could have a significant impact on the cost and availability o credit for housing. Further, it will lead to the imposition of new operational c sts on the

National Association of Mortgage Brokers
Response to Questions Posed by
Congressman Rubén Hinojosa
House Financial Services Committee
Subcommittee on Financial Institutions
"The Role of FCRA in the Credit Granting Process"
August 1, 2003
Page 5

industry, which will result in an increase in the cost of credit for consumers and a reduction in the access to credit for consumers. As such, NAMB believes it is important that the federal preemption provisions of FCRA be extended so that our current national credit system remains fluid, workable and continues to provide consumers with strong benefits and protections.

FCRA, as amended, provides uniform national standards that have increased the effectiveness of consumer report information that plays a fundamental role in the mortgage origination process. A mortgage broker's ability to obtain information about a consumer's credit is as essential to their business as is the ability to transfer that information across state lines for the benefit of the consumer. Permitting states to enact inconsistent credit system laws will disrupt the current free flow of information that enhances interstate commerce. If laws vary from state to state, it will be very difficult to maintain a practical and reliable credit system that promotes efficiency in the marketplace that consumers currently enjoy. Failure to continue our current national uniform system will have a sweeping impact on every sector of the economy, from consumers to retailers to employers. It could also have a detrimental impact on this country's housing market - one of the only markets sustaining this economy.

The current national uniform system also promotes competition throughout the industry. As a result of competition, consumers are presented with more opportunities and choices in obtaining a mortgage. This competition enables mortgage brokers to do what they do best – place consumers in homes.

Response to Rep. Hinojosa from Mike Vadala
June 12, 2003 hearing entitled "The Role of FCRA in the Credit Granting Process"

Questions for all on Panel II

1. Do you know how FICO is developed, and do you know what factors are incorporated in the score?

Mr. Vadala: I believe I know what the highest weighted factors are, but could not say 100% how it is calculated, as the credit bureaus do not release that information. Those top factors include: Payment history, length of credit history, types of credit, and how much credit you have.

2. If so, with whom can the information be shared?

Mr. Vadala: You would have to ask the credit bureaus that question as they are the ones that know how it is developed.

3. What is your understanding of what is allowed to be done with the information contained in the credit report and, separately, of the score that is received from the credit bureaus?

Mr. Vadala: At The Summit FCU we only pull the credit report when someone comes in. We do not share this information with other parties. As to what is allowed or what others do, I don't know.

4. How much are the major credit reporting agencies paid per report? Is it as much as the approximately $29 consumers would have to pay for both the credit report and the score?

Mr. Vadala: We pay approximately $2 for the report and score from the bureau we use. It is my understanding that due to the large volume that we do with the credit bureau and our ability to receive these reports electronically, we are able to get them at a lower rate.

Testimony
Of
Fannie Mae
3900 Wisconsin Avenue, N.W.
Washington D.C.

before the

Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
United States House of Representatives

108th Congress, 1st Session

Hearing on
"The Role of FCRA in the Credit Granting Process"

June 12, 2003

Chairman Bachus and Ranking Member Sanders, thank you for the opportunity to submit for the record testimony to the Subcommittee on Financial Institutions and Consumer Credit of the House Financial Services Committee on the Fair Credit Reporting Act. Fannie Mae appreciates and strongly supports the Committee's efforts to examine the Fair Credit Reporting Act. We believe that the Fair Credit Reporting Act has served an important role in helping to create an efficient uniform national credit reporting system and support the reauthorization of the preemption provisions set to expire at the end of this year, particularly as they relate to the content of the information contained in consumer credit reports.

Fannie Mae operates exclusively in the secondary mortgage market, where we help to ensure that money for mortgages is available to home buyers in every state across the country, every day. We do this by accessing the international capital markets to provide liquidity to banks, mortgage banks, credit unions, and a variety of other financial institutions that use such available funds to originate mortgage loans to consumers. There are two primary ways in which we accomplish this mission. First, we purchase mortgage loans that are originated by financial institutions and hold these loans in our portfolio. Second, we issue mortgage-backed securities (MBS) in exchange for pools of mortgage loans that we receive from financial institutions.

Unlike some financial services companies that purchase mortgage loans in the secondary market or issue mortgage-backed securities, our charter precludes us from originating mortgages or otherwise engaging in mortgage transactions with consumers. As an investor in mortgage loans that does not have a direct relationship with consumers, Fannie Mae does not make any credit decisions that determine whether a consumer will receive a loan. Financial institutions in the primary market are responsible for making the decision whether to extend credit to any particular borrower.

That is not to say, however, that the efficient operation of the credit reporting system does not impact our business. On the contrary, credit information assists Fannie Mae in conducting its business, most importantly, in assessing the risks it undertakes on loans that it purchases.

Indeed, credit information has always been important to the entire mortgage industry because of the strong correlation between borrowers' credit histories and whether a loan will be repaid. A national and standardized system of credit reporting has become particularly important in the mortgage industry over the last seven years with the introduction and growth of Automated Underwriting Systems (AUS), such as Fannie Mae's Desktop Underwriter, that are programmed to receive credit data in a uniform format. AUS are designed to provide underwriting guidance to lenders through use of empirical models that enable the underwriting process to occur more quickly, more objectively and highly accurately. These systems attempt to measure credit risk by assessing a constellation of characteristics about the loan transaction and the applicant, including, for instance, the loan-to-value ratio, debt-to-income ratio, amortization term, and reserves held by the applicant.

Automated underwriting systems, including Desktop Underwriter have created enormous efficiencies in the mortgage origination process. Currently, most lenders evaluate mortgage applications using automated underwriting systems. AUS have expanded the number of loans lenders can make by significantly reducing the cost of originating a loan and allowing lenders to tailor loan terms based on an individual borrower's risk profile.

For AUS to provide accurate determinations of a mortgage applicant's ability to repay a mortgage loan, primary market lenders must have access to comprehensive credit histories of potential borrowers. Fannie Mae is concerned that if the preemption provisions of the Fair Credit Reporting Act are not reauthorized and the mortgage industry was no longer able to rely on credit report information because of state-by-state variation in how credit data is collected, reported, and maintained, there would be profound impact on the way both primary and secondary mortgage market participants are able to manage mortgage risk.

Just as credit markets are nationwide and the delivery of financial services to consumers is not bound by the borders of each state, AUS are national in scope and rely on consistent credit reporting from state to state. If, instead of a uniform national standard, each state formulated its own credit reporting standards, homebuyers could face higher costs and higher interest rates and lenders could be forced to say no to more mortgage applicants. In addition, it might make it necessary for both Fannie Mae and other secondary mortgage market participants to have different underwriting criteria for different states – a development that could adversely impact our national secondary mortgage market efficiency.

The cost of allowing states to regulate independently the contents of credit reports and the furnishing of information to consumer reporting agencies may be significant.

Any benefit of stricter state legislation could ultimately be lost to consumers because of the negative effect that varying state standards may have on not only the mortgage market, but also consumer credit generally.

While Fannie Mae believes that a strong, uniform national standard for credit reporting is integral to a well-functioning national mortgage market, it also believes that companies that benefit from the credit reporting system should do their part to ensure that the system contains accurate and complete information. Therefore, Fannie Mae requires each financial institution that services Fannie Mae loans to certify that they have procedures and controls in place to provide (on a monthly basis) the major credit repositories with a "full-file" status report on all of the mortgages it services for us. "Full-file" reporting means that the servicer must provide both positive and negative payment information about each mortgage it is servicing as of the last business day of each month.

Thank you for the opportunity to submit testimony on this important issue. We look forward to working with the Committee as it continues to review the Fair Credit Reporting Act.