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SYMPOSIUM—CREDIT REPORTING AND CREDIT SCORING

Foreword

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I spent my entire academic career studying the Great Depression. The depression may have started because of a stock market crash, but what hit the general economy was a disruption of credit. Average citizens, unable to borrow money. To do anything; to buy a home, start a business, stock the shelves. Credit has the ability to build a modern economy, but lack of credit has the power to destroy it. Swiftly and absolutely![1]

This line, delivered by Paul Giamatti in his portrayal of Federal Reserve Chairman Ben Bernanke in the HBO Movie, *Too Big To Fail*, is just as true about the individual American consumer as it is about the total American economy. A lack of credit or the inability to build a credit history has the ability to destroy an individual's chance at upward financial mobility. Today, a person without good credit gets penalized in almost every aspect of his or her financial existence. The penalties include higher interest rates because these individuals represent an increased risk when borrowing, as well as increased insurance rates, less access to rental housing, and the potential of lost employment opportunities. Worse yet, some will be punished by the inability to even obtain insurance or put a roof over their heads. Without a good credit history, the opportunity to improve one's personal financial standing becomes daunting at best, and sadly, impossible for all too many income-challenged

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1. TOO BIG TO FAIL (Home Box Office 2011).

Americans.

Most consumers have brought about their credit problems by their own actions, including nonpayment of their obligations, and it is prudent to document this information for future prospective creditors as a way to protect the system for all Americans. Some consumers, however, are victims of errors in a system seemingly designed to hinder their efforts to make corrections. As you will read in the symposium articles, many consumer advocates believe the system is set up to hold back certain consumers from advancement. These advocates believe the credit scoring system is biased and filled with errors. They believe that the credit reporting system itself is biased by design, promotes disparate impact, and only provides fair representation to those who already have credit. There are certainly elements of the current credit reporting system that prompt debate, especially aspects related to the recent evolution of the system in place today, and we will address these issues.

Conversely, these claims must be balanced in the debate with respect to the rights of all consumers. Access to credit has been essential in building today's economy and is good for all. Disparate impact must be critically weighed, considering that the individual's own actions are documented, and personal responsibility is the key issue. The increased transparency of today's credit system promotes personal responsibility, especially in the credit scoring area. Granted, increased consumer awareness has created some misinformation issues; however, these issues can be corrected and, overall, there has been vast improvement compared to the restrictive policies of a few short years ago.

In this Foreword we will examine the American credit reporting system as it relates to some of the most hotly debated topics of the symposium. We will look at the system from the consumer's perspective and from the view of those within the industry itself, and we will also address the role our government plays in the system. We will look at both the advancements and the failures, more often focusing on the shortcomings, as this writer believes that improvement of the system can only be obtained by better efforts from each group. Because honesty is necessary for improvement, we will need to address where the consumer is at fault as well as the faults of the credit industry. We will also address government's necessary role in mediation, because this system is too crucial to our nation's economic well-being to be left completely reliant upon market forces. All three entities are partners in the system, dependent upon each other for success and inseparable in their existence. Open debate regarding each entity's role, combined with the materials presented in this symposium, will hopefully help develop a better understanding of the credit system and, in turn, its improvement; a healthy credit system is fundamental to a stronger economic tomorrow for both the consumer and the industry, and in turn the nation.

The impact of the credit industry on the daily life of the American consumer is as large as the massive industry itself. One of the unique aspects of the credit

system is that unlike most other industries, individuals have no choice but to participate or face significant financial hardship. The "opt out" feature causes perilous ramifications. To provide a mental picture regarding size: in December 2012, the Consumer Financial Protection Bureau (CFPB) released some initial findings on its new oversight of the credit reporting industry. Some of the findings highlighted the enormity of the databases at the three national credit repositories: TransUnion, Equifax, and Experian. Each of these companies maintains files on more than 200 million American adults.[2] These files contain information from approximately ten thousand creditors or data furnishers and provide monthly updates on more than 1.3 billion individual consumer-credit accounts called "trade lines."[3]

The vast majority of this data comes from a few sources, both by institution and by lending product. The ten largest financial institutions in the United States furnish more than half of all of the information used in credit reporting systems.[4] After the top ten, the field does not get much wider: "the top 50 furnishers provide 72% of the trade lines, and the top 100 furnishers provide 76% of the trade lines in their databases."[5] As for the type of data, "revolving credit cards account for nearly 60% of all trade lines."[6] The CFPB found that consumers contacted the repositories approximately eight million times in 2011 to initiate disputes regarding the accuracy of one or more items in their credit files.[7] This represented between 32 million and 38 million disputed items on consumers' credit files in a single year.[8] Disputes ranged widely based upon the type of data furnished, with information reported by collection agencies constituting the highest dispute rates. While collection accounts only made up 1.1% of all trade lines in consumer reports, they represented nearly 40% of disputes.[9]

The accuracy of these massive databases and the efficiency of the dispute process are frequently questioned, vigorously debated aspects of the credit reporting industry. I was honored to serve as the discussant at the National Consumer Law Center/Suffolk University Law School symposium segment on accuracy and disputes in June 2012. Accuracy is a topic of interest that I have pursued extensively for more than a decade, since designing the concepts for the Consumer Federation of America/National Credit Reporting Association accuracy study in 2002, to be discussed later.

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2. *See* CONSUMER FIN. PROT. BUREAU, KEY DIMENSIONS AND PROCESSES IN THE U.S. CREDIT REPORTING SYSTEM: A REVIEW OF HOW THE NATION'S LARGEST CREDIT BUREAUS MANAGE CONSUMER DATA 3 (2012), *available at* http://files.consumerfinance.gov/f/201212_cfpb_credit-reporting-white-paper.pdf.

3. *See id.*

4. *See id.* at 14.

5. *Id.*

6. CONSUMER FIN. PROT. BUREAU, *supra* note 2, at 3.

7. *See id.* at 27.

8. *See id.*

9. *See id.* at 4.

Processing disputes is a fundamental component of accuracy, to which the CFPB's investigation of the industry's highly automated dispute processing system called e-OSCAR could provide great consumer benefits. This system is operated by the repositories' trade association, the Consumer Data Industry Association, and its use is unavoidable for anyone who reports data to the system. The e-OSCAR process converts disputes into a code indicating the nature of the consumer's dispute, with approximately one quarter of the cases including explanatory text.[10] CFPB reported that approximately 15% of trade line disputes were resolved without involvement by the credit furnisher.[11] The remaining 85% of disputes were referred to data furnishers through e-OSCAR.[12] The Fair Credit Reporting Act (FCRA) requires the furnisher of the disputed data to investigate the dispute and report back to the repository within a thirty- to forty-five-day timeline.[13]

Currently, the e-OSCAR system does not allow for supporting documentation provided by the consumer to be routinely forwarded to the data furnisher. This lack of forwarded documentation is a weak link in the dispute process, commonly called into question by consumer advocates and a popular source of complaints about the system. Consumer complaints about credit-reporting processes, either directly or as part of problems encountered in relation to identity theft, are among the top consumer complaints made to the Federal Trade Commission (FTC). Identity theft has led this list as the top complaint received by the FTC for the past thirteen consecutive years,[14] and lingering problems associated with victims' credit reports are one of the most common elements of consumer complaints about identity theft. Because it is directly tied to accuracy, the CFPB will most likely conduct an in-depth review of the consumer-dispute process as it delves into examinations of the industry. Alterations to the process—specifically the initiation of a mechanism for consumers to forward supporting documents when filing disputes—seems like a logical step when considering consumer complaints and addressing the accuracy of the data.

The debate surrounding data accuracy is one of the most hotly contested credit reporting issues. The symposium segment at which I was discussant in June 2012, titled "Report Accuracy & Disputes," brought enticing presentations by Beth Freeborn of the FTC, Persis Yu of the National Consumer Law Center, Jonathan Fox of The Financial Clinic, and Joanne McNabb of the California Office of Privacy Protection. Each of the participants offered thought-

10. *See* CONSUMER FIN. PROT. BUREAU, *supra* note 2, at 4.

11. *See id.*

12. *See id.*

13. *See id.*; *see also* Fair Credit Reporting Act, Pub. L. No. 91-508, § 611, 84 Stat. 1114 (1970) (current version at 15 U.S.C. §§ 1681i (2012)).

14. *See FTC Releases Top 10 Complaint Categories for 2012*, FED. TRADE COMMISSION (Feb. 26, 2013), http://ftc.gov/opa/2013/02/sentineltop.shtm.

provoking research and documentation, in order to show that the data-accuracy debate must continue. The FTC's research speaks volumes on its own, and it received an added voice from the network news in CBS's *60 Minutes* segment titled "40 Million Mistakes."[15] This episode was aired on February 10, 2013, the day before the FTC released an eight-year, congressionally mandated accuracy study.[16]

This symposium uses two key points from a 2010 FTC report that warrant additional discussion. These points address the errors that "help" people and errors of omission.[17] It is important to discuss the errors that "help" people because while these errors may have an initial helpful impact, the overall benefit is questionable if the consumer is allowed to obtain more credit than he or she can successfully maintain. The FTC did not address the errors of omission; they point out that the system is voluntary, and if the data is not part of the system, how can it be wrong?[18] In reality, however, missing data can be just as harmful to a consumer as *incorrect* data. Credit-scoring models calculate the utilization rate (the ratio between the amount of credit available to the consumer and the amount of credit in use) as the second most important aspect of a consumer credit history. When accounts are missing from this calculation it skews the score dynamics and harms the consumer. This outcome can have a positive or negative impact on the score in the short term; however, if accuracy is the desired outcome, these items all warrant continued discussion.

While we focus on the accuracy issue and the negative light cast on the industry because of accuracy problems, it is vitally important as one digests the symposium research to remember that the vast majority of this massive database is highly accurate. Persis Yu's symposium research indicated that more than half of the reports contained at least one wrong trade line; however, that number may be skewed, because there was no quality control to verify the consumers' claims that the trade line was incorrect.[19] Unfortunately, one of the problems the industry faces with regard to accuracy is the consumers themselves. The sad reality is that many consumers will not admit to negative marks on their credit history, in an attempt to escape their obligations.

Consumers and the industry must work together to combat the accuracy

15. *See 60 Minutes: Attack in Algeria/40 Million Mistakes/Lincoln* (CBS television broadcast Feb. 10, 2013).

16. *See In FTC Study, Five Percent of Consumers Had Errors on Their Credit Reports That Could Result in Less Favorable Terms of Loans*, FED. TRADE COMMISSION (Feb. 11, 2013), http://www.ftc.gov/opa/2013/02/creditreport.shtm.

17. *But see* JON LEIBOWITZ ET AL., FED. TRADE COMM'N, REPORT TO CONGRESS UNDER SECTION 319 OF THE FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003, at 7 (Dec. 2010), *available at* http://www.ftc.gov/os/2010/12/101230facta-rpt.pdf.

18. *See id.* (discussing decision not to address errors in consumers' favor).

19. Persis Yu, Remarks at the Symposium on Credit Scoring and Credit Reporting, Suffolk University Law School (June 6, 2012).

issues. Even honest consumers can make innocent mistakes and unknowingly cause problems with accuracy in their own files. Do not forget those consumers who lie about their identities (some are U.S. citizens and some are members of organized international crime syndicates) and wreak havoc on the system by stealing the identities of innocent Americans for financial gain. These types of unscrupulous activities, combined with the simple errors by both consumers and industry participants, create an environment that makes total accuracy impossible. Because it is unattainable, total accuracy has never been the goal; the standard set by the FCRA in 1970 is "reasonable procedures to assure maximum possible accuracy . . . ."[20] It is this writer's belief that this applies to consumers as partners in the process, as well as to the industry itself.

Consumers can support the improvement of accuracy simply by applying for credit in the exact same manner each time they make applications. For example, a person who goes by John, Jonathan, or Jack may use all three of these names on various applications. Combine that with the random use of the middle initial and/or the junior/senior generational designation, and things can get confusing. Does this person use his full name, middle initial, and junior or senior (if applicable) for every transaction or only on the more important ones, like a car loan or mortgage application? If you consider the way computer systems work, it follows that the more we program to account for variations, the more assumptions will be made via technology. Missing and fractional information must be "decoded" by a computer that decides the real identity of each consumer in the 200-million-consumer databases. Remember that these databases are also constantly changing because they update more than 1.3 billion trade lines each month with new information, as they are attacked by innocent mistakes and criminals intent on committing fraud. File matching is very challenging, and a mixture with other files, especially in situations like the aforesaid example, is almost impossible in some cases. When completing a credit application, be it quickly at a sporting event to get a free team hat or other souvenir from a credit card company, or more importantly for a car loan or mortgage, consumers should use their full, correct names and generational designations each time. Consistency is the ally, and it is the consumers' own "reasonable procedure for maximum possible accuracy."[21]

The symposium research provided by the California Office of Privacy Protection exposes some of the extreme levels that individuals will take to dishonestly attack and exploit the system, along with an extreme example of the tragic outcomes this produces. The report on identity-theft issues occurring with minors in the Los Angeles foster-care system, discussed during the

20. *See* Fair Credit Reporting Act, Pub. L. No. 91-508, § 607(b), 84 Stat. 1114, 1131 (1970) (codified as amended at 15 U.S.C. § 1681e (2012)).

21. *See id.*

symposium presentations in June 2012, is heartbreaking.[22] The realization that people will target children in foster care for financial gain, further adding to these children's struggle to successfully move into adulthood, shows that rooting out dishonest and criminal activity is a difficult issue. Studies like this are not a surprise to many, and they further illustrate why accuracy is such a debated issue.

Much notable research has been done by both industry and consumer advocacy groups. The Associated Credit Bureaus (ACB), now known as the Consumer Data Industry Association (CDIA), designed a study to help convince mortgage giants Fannie Mae and Freddie Mac—the formerly government-sponsored enterprises (GSEs) (now in receivership after the financial crisis required their bailout)—that accuracy would not be compromised by the use of the tri-merge report instead of the Residential Mortgage Credit Report (RMCR). The tri-merge is simply the automated merging of the data from all three repositories, with a computer elimination of the duplicated data, which can be done almost instantly. The tri-merge report was used in the industry as a prequalification tool, before ordering the RMCR. The RMCR starts with the tri-merge and adds a list of required manual verifications to create a more complete report. This process will be discussed in more detail later in this Foreword.

In 1991, the ACB commissioned the accounting firm Arthur Andersen (AA) to conduct research on the accuracy of the national credit databases.[23] The ACB/AA study was reported as a random sample of 15,703 consumers' credit applications from five lenders.[24] These consumers had been denied credit based on the information contained within their credit reports.[25] These denials were tracked to see if the consumers exercised their rights to obtain a free copy of their credit reports after the adverse credit decisions.[26] Those consumers who did obtain a copy of their credit report were further monitored in case a dispute was filed challenging the accuracy of the data in the report.[27] After the credit bureaus investigated these disputes, if the dispute resulted in a change in

22. *See generally* CAL. OFFICE OF PRIVACY PROT., A BETTER START: CLEARING UP CREDIT RECORDS FOR CALIFORNIA FOSTER CHILDREN (Aug. 2011), *available at* http://oag.ca.gov/sites/all/files/agweb/pdfs/privacy/foster_youth_credit_records.pdf?.

23. This full report was never made available to the public; however, the revised calculations conducted via the Executive Summary were released, and various articles were written about it. *See* CREDIT REPORT RELIABILITY STUDY: EXECUTIVE SUMMARY 1-2 (Feb. 4, 1992), http://cdia.files.cms-plus.com/PDFs/andersen executivesummary.pdf; *see also* MICHAEL TURNER ET AL., COMPARING FTC AND PERC STUDIES ON MEASURING THE ACCURACY OF U.S. CONSUMER CREDIT REPORTS 10 (Apr. 2013) (discussing ACB study), *available at* http://www.perc.net/wp-content/uploads/2013/04/Comparing-FTC-and-PERC-Studies.pdf.

24. *See* Daniel B. Klein & Jason Richner, *In Defense of the Credit Bureau*, 12 CATO J. 393, 407 (1992) (discussing Arthur Andersen study).

25. *See id.*

26. *See id.*

27. *See id.* at 407-08.

the repository credit file, the original lender was requested to reconsider the consumer's application based on the updated credit data.[28] The final results: of 15,703 consumers studied, the original decision was reversed in only 36 cases, for an error rate of just 0.2%.[29]

The result of the ACB/AA study was in direct conflict with other credit report accuracy investigations at the time.[30] The other studies were conducted by consumer advocacy groups such as the United States Public Interest Research Group (US PIRG)[31] and the Consumers Union (CU),[32] typically with small and nonrandom credit samples, and reaching vastly differing results: error rates as high as 70% were found.[33] While industry insiders knew that the data was more accurate than what was being reported in those limited studies by the consumer advocacy groups, the questions remained: What was the real error rate and what was the statistical difference between the two report types? The National Consumer Reporting Association (NCRA) (then known as the National Association of Independent Credit Reporting Agencies, or NAICRA) commissioned its own study via its members using randomly selected live credit reports currently being reviewed for mortgage applications. NCRA members reviewed 1710 consumer credit reports, comparing and contrasting the data of the two-bureau RMCR with the new standard tri-merge, looking at both data accuracy and data completeness in each report type.[34]

The NCRA found significant differences in the two report types, and some troubling findings:

- 29% of Trades, 15% of Inquiries, and 26% of Public Records in the tri-merge were duplicates;
- 44% of the tri-merge had missing balance and/or payment information;
- Most importantly, 30% of the RMCRs had accounts belonging to the consumer that had been completely missed by the tri-merge;
- 19% of the tri-merge files had accounts with balances reported as older than ninety days;

28. *See* Klein & Richner, *supra* note 24, at 408.

29. *See id.* at 407-08.

30. *See* John Bare, *Almost Half of Credit Reports Checked Contained Errors*, PHILLY.COM (Apr. 30, 1991), http://articles.philly.com/1991-04-30/business/25777003_1_credit-bureaus-credit-reports-trw-credit-data (reporting on Consumers Union study finding 48% error rate in reports examined).

31. *See generally* U.S. PIRG, www.uspirg.org (last visited Nov. 10, 2013); *see also generally* NAT'L ASS'N OF STATE PIRGS, MISTAKES DO HAPPEN: A LOOK AT ERRORS IN CONSUMER CREDIT REPORTS (June 2004), *available at* http://georgiapirg.org/sites/pirg/files/reports/MistakesDoHappen2004-1.pdf.

32. *See generally* CONSUMERS UNION, www.consumersunion.org (last visited Nov. 10, 2013).

33. *See* NAT'L ASS'N OF STATE PIRGS, *supra* note 31, at 6.

34. *See* KAREN SLEZAK ET AL., NAT'L ASS'N OF INDEP. CREDIT REPORTING AGENCIES, INC., SURVEY/STUDY: THREE BUREAU MERGED INFILE VS. TWO BUREAU RESIDENTIAL MORTGAGE CREDIT REPORT 5 (Mar. 1994).

- 16.5% of the RMCRs had removed derogatory data as a result of the investigation;
- 3% of the RMCRs had removed current data that belonged to another consumer; and
- 2% of the RMCRs had identified erroneous public record information.[35]

Additionally, there was an estimated 25% total error rate in the tri-merge that would have been corrected with an RMCR.[36] One of the most surprising findings in the study was that the third bureau added only 2% unique data not found on the other two bureau files.[37]

Real world experiences did not back up the 0.2% error rate found in the ACB/AA study, as complaints about credit report inaccuracies continued. While details regarding the ACB/AA study have never been completely released, information that was released over time revealed that the ACB/AA study contained a serious design flaw that greatly understated the error rates. This flaw in the study methodology was buried in the calculations. The study made a major assumption regarding the accuracy of the data in the credit reports. It assumed that there was only an error if the consumer proactively elected to write to the credit bureau to request a copy of the consumer's credit file. The ACB/AA methodology relied on the consumer being proactive; the consumer needed to read and understand the required adverse-action notice when being denied credit. If the consumer did not write to the credit bureau seeking a copy of his or her credit report after being denied credit, the study assumed that all of the data in the report was accurate.

Of the 15,703 credit reports the ACB/AA tracked for this study, 14,480 of the consumers (who were completely unaware that they were being studied) never requested a copy of their reports.[38] It seems completely unreasonable to assume that just because a consumer did not write to request a copy of his or her credit report, the data in the report is in fact accurate. This methodology further assumes that every consumer who did obtain a copy of his or her report actually reviewed it, comprehended the data contained within it, and took the additional step to write a letter of dispute on any discrepancies found.

A more accurate methodology would have moved credit reports that were never reviewed by the consumer for accuracy into a neutral stance. By moving the 14,480 "accurate" consumer reports into a neutral position (because their

35. *See id.* at 9; *see also* CONSUMER FED'N OF AM., NAT'L CREDIT REPORTING ASS'N, CREDIT SCORE ACCURACY AND IMPLICATIONS FOR CONSUMERS 7 (Dec. 2002), *available at* http://www.consumerfed.org/pdfs/121702CFA_NCRA_Credit_Score_Report_Final.pdf (discussing NAICRA study findings).

36. *See* SLEZAK ET AL., *supra* note 34, at 9, 12.

37. *See id.* at 10.

38. *See* Brad Scriber & Terry Clemans, Consumer Fed'n of Am. Workshop on Credit Score Accuracy and Implications for Consumers, at slide 28 (June 30, 2004) (on file with author).

accuracy was based on unreasonable assumptions), and then recalculating the rest of the findings, the ACB/AA study results produce an error rate of 22%.[39]

The CDIA provided funding for another accuracy study on behalf of the industry, released in May 2011.[40] This study, conducted by the Policy and Economic Research Council (PERC), claimed that less than 1% of consumer reports contained errors requiring adjustment of twenty-five points or more.[41] At face value, the study is very compelling, with its impressive peer reviews from prestigious universities; however, similar to the ACB/AA study, in-depth analysis of the methodology raises serious questions about the outcome. Indeed, the study received so much criticism that the PERC issued a follow-up response in August 2011, defending the findings.[42]

In December 2002, the Consumer Federation of America (CFA) and the NCRA formed a partnership and conducted the most comprehensive credit-accuracy study ever done.[43] The partnership between CFA and NCRA was meant to balance consumer advocacy and industry interests, in order to get to the bottom line on accuracy. Credit scores and reports were collected from actual mortgage loan applications from each of the repositories on more than 500,000 consumers, and then analyzed to show many disparities.[44] The following is a summary of this study's findings:

- The CFA/NCRA analyzed 502,623 credit files with scores from all three major credit-reporting agencies—the largest sample ever examined. Every state and territory in the nation was represented.
- Nearly one out of three files (29%) had a score discrepancy among the three reporting agencies of 50 points or more. Credit scores range from about 400 to about 800.
- 4% of files had a discrepancy of 100 points or more.
- The average discrepancy was 41 points (with a median discrepancy of

39. *See id.* at slide 21.

40. *See* MICHAEL A. TURNER ET AL., POLICY & ECON. RESEARCH COUNCIL, U.S. CONSUMER CREDIT REPORTS: MEASURING ACCURACY AND DISPUTE IMPACTS 4 (May 2011), *available at* http://perc.net/wp-content/uploads/2013/09/DQreport.pdf (acknowledging CDIA funding for PERC research study).

41. *See id.* at 8 (finding 0.93% of credit reports examined contained disputes resulting in 25-point or greater credit score increase); *see also Less than One Percent of Credit Reports Have Errors that Could Adversely Impact Consumers, New Study Shows*, PR NEWSWIRE (May 5, 2011), http://www.prnewswire.com/news-releases/less-than-one-percent-of-credit-reports-have-errors-that-could-adversely-impact-consumers-new-study-shows-121318809.html (reporting on same study).

42. *See generally* POLICY & ECON. RESEARCH COUNCIL, GENERAL RESPONSE TO CRITICISMS OF RECENT PERC REPORT: U.S. CONSUMER CREDIT REPORTING: MEASURING ACCURACY AND DISPUTE IMPACTS (Aug. 2011), http://perc.net/wp-content/uploads/2013/09/GR.pdf (last visited Nov. 10, 2013).

43. *See Fair Credit Reporting Act: How It Functions for Consumers and the Economy Before the Subcommm. on Fin. Insts. & Consumer Credit of the H. Comm. on Fin. Servs.*, 108th Cong. 311 (2003) (testimony of Ed Mierzwinski, Consumer Program Director, U.S. Public Interest Research Group), *available at* www.gpo.gov/fdsys/pkg/CHRG-108hhrg92232/html/CHRG-108hhrg92232.htm.

44. *Id.*

35 points).

- Roughly eight million consumers—one in five of those who are at risk—are likely to be misclassified in loan underwriting, based on the study's review of credit files for errors and inconsistencies. A similar number are likely to benefit from errors in their reports.
- Because only mortgages require the use of the tri-merge, consumers in all of the other transactions do not benefit from system-wide averages and should not have to cope with a credit-reporting system that functions as a lottery pending which score is accessed for their loan application.[45]

While the most recent FTC findings are the latest word in accuracy, it seems likely they will not be the last. Inaccuracies hit consumers hard when they are innocent victims of the errors, regardless of whose number you use—even the lowest estimate of a 1% error rate means that two million Americans (the entire population of Houston, according to the 2010 census) are being harmed by these errors. Both the industry and consumers, with strong assistance from government, need to become more aware and find ways to lower that number.

Before going further, we must identify some of the primary industry segments that are of critical importance to the issues of the symposium and clearly outlined in the FCRA. Two industry segments are obvious and will receive the vast majority of the focus: the information furnishers, which are the credit-provider companies whose data is being collected and maintained; and the national consumer reporting agencies, defined in section 603(p) of the FCRA, which we will refer to as the repositories.[46] In addition to the repositories, there are other types of nationwide, specialty consumer-reporting agencies defined in section 603(x) of the FCRA that offer unique reports with information not found in the repositories.[47] These are typically databases for specific purposes, such as ChexSystems, which tracks consumers who have issued nonsufficient funds or closed account checks.[48] These consumer-reporting agencies have historically operated in the shadows of the repositories; however, they have come under increased scrutiny for FCRA compliance. Recently, the CFPB has put these firms on notice that they will be monitored for violations of the FCRA, including the free-annual-credit-report provision.[49]

45. *Id.* (citing CONSUMER FED'N OF AM., CREDIT SCORE ACCURACY AND IMPLICATIONS FOR CONSUMERS (Dec. 2002), *available at* http://www.consumerfed.org/pdfs/121702CFA_NCRA_Credit_Score_Report_Final.pdf).

46. *See* 15 U.S.C. § 1681a(p) (2012).

47. *See id.* § 1681a(x).

48. *See Frequently Asked Questions*, CHEXSYSTEMS CONSUMER ASSISTANCE, http://www.consumerdebit.com/consumerinfo/us/en/chexsystems/faqs.htm#FAQ_01 (last visited Nov. 10, 2013).

49. *See Consumer Financial Protection Bureau Issues Warnings to Nationwide Specialty Consumer Reporting Agencies*, CONSUMER FIN. PROT. BUREAU (Nov. 29, 2012), http://www.consumerfinance.gov/press

Insight into a group known as resellers, defined in section 603(u) of the FCRA, is needed because their role is unknown to many and often misunderstood.[50] The symposium comments from June 2012 made it clear that this Foreword should provide an understanding of the resellers' role in the industry; resellers provide the reports for the most important life transactions the American public makes. Obtaining employment, securing an apartment, and financing a home are all areas of consumer reporting dominated by resellers who offer much more than merely reselling the repository's raw data.

Resellers do not maintain monthly updated databases of consumer information. They provide reports containing data accessed from one or all of the credit repositories, as well as other sources, for a specific, single use in a complex transaction. These companies' primary purpose is to create the (sometimes highly manual-labor intensive) reports for mortgage, tenant, and employment purposes. The requirements of each of these three specialty markets are unique and demand much more than what the basic credit repository file could provide. Additional data is often added or updated to complement the data originally provided by the repositories, in order to more thoroughly assess the risk associated with these important transactions. In the case of mortgage-credit reports, for example, information from all three of the national repositories is required. For tenant-screening reports, a single repository may be sufficient; however, it will likely be combined with other public records. Contrary to popular opinion, credit information is rarely used for employment-screening reports, and when it is requested, it is a summarized version. We will examine each of these reports in greater detail.

The credit-reporting process for mortgage transactions is different from all other credit transactions. Mortgage originators do not obtain credit reports directly from the national credit repositories; they access specialty credit reports from third parties (mortgage-credit-reporting companies) that contain data from all three repositories (a tri-merge or three-file merge), as required by the underwriting guidelines of Fannie Mae,[51] Freddie Mac,[52] and the United States Department of Housing and Urban Development (HUD).[53]

One of the most misunderstood aspects of the reseller is in regards to mortgage lending. In today's market, only one of the three national credit repositories, Equifax (via its reseller division, Equifax Mortgage Services

releases/consumer-financial-protection-bureau-issues-warning-to-nationwide-specialty-consumer-reporting-agencies.

50. *See* 15 U.S.C. § 1681a(u).

51. *See Credit Report Requirements in Desktop Underwriter*, FANNIE MAE, https://www.fanniemae.com/content/job_aid/du-credit-report-requirements.pdf (last visited Nov. 10, 2013).

52. *See Using Loan Prospector® Merged Credit Report Options*, FREDDIE MAC, http://www.freddiemac.com/learn/pdfs/uw/using_mc.pdf (last visited Nov. 10, 2013).

53. *See Section C. Credit Reporting Requirements*, HUD 1-C-4, http://portal.hud.gov/hudportal/documents/huddoc?id=4155-1_1_secC.pdf (last visited Nov. 10, 2013).

(EMS)), operates a reseller business model and produces the type of credit reports required for mortgage lending.[54] Even though Equifax is a national repository of its own data, EMS is a reseller because it purchases credit data from TransUnion and Experian to merge with its Equifax data. This information creates a mortgage-credit report that is resold to the mortgage lender. While TransUnion and Experian both previously had mortgage-reporting divisions, they have not had wholly owned mortgage-reporting companies for more than five years.[55] Today, there are approximately sixty independent firms in the United States that provide these services, as identified by Fannie Mae and Freddie Mac.[56]

The mortgage-credit-reporting companies also provide mortgage lenders and consumers the ability to quickly update and correct their credit reports within the time-sensitive mortgage-underwriting requirements. There are two traditional methods for changing data on consumer credit reports: the consumer, acting on his own, can contact the furnishers and credit bureaus to make changes under the FCRA's dispute process (more on this subject later); or the consumer can work with the mortgage originator to file a dispute through the reseller. The reseller has the ability to change the report used by the lender for the mortgage application, in a process called "rescoring," where the mortgage-credit report and a revised score based on new and/or corrected credit data are placed in the repositories' files within two to three business days. The mortgage-credit-reporting agency must be directed by the lender and will work with the consumer to obtain documentation about the erroneous data in the credit report, verify the documentation directly with the creditor, and submit the findings to a special rescoring department at each of the repositories. The rescoring process was developed in the late 1990s, to compensate for the shortcomings of the tri-merge report within the restrictions of the GSE's automated underwriting systems.

The procedures for producing an RMCR required information and research far beyond the basic data found in the repositories.[57] The data available from

54. *See Equifax Mortgage Services*, EQUIFAX, http://www.equifax.com/mortgage (last visited Nov. 10, 2013).

55. *See MDA Buys Real-Estate Services Assets from TransUnion*, REUTERS, Feb. 26, 2008, http://www.reuters.com/article/2008/02/26/mda-transunion-idUSN2636898120080226; *First American Acquires Experian Real Estate Services*, PR NEWSWIRE (Apr. 15, 2005), http://www.prnewswire.com/news-releases/first-american-acquires-experian-real-estate-services-54297107.html.

56. *See Credit Information Providers*, FANNIE MAE, https://www.fanniemae.com/singlefamily/credit-information-providers (last visited Nov. 10, 2013); *Credit Reporting Companies and Technical Affiliates*, FREDDIE MAC, http://www.loanprospector.com/about/crc.html (last visited Nov. 10, 2013). Both of these websites contain some duplicate listings, as some of the credit-reporting agencies operate different technology providers or market services under multiple business names. These lists must be reconciled in order to determine the actual number of independent providers, which currently shows approximately sixty independent credit reporting companies that can provide credit reports meeting the requirements of Fannie Mae and Freddie Mac.

57. *See U.S. Department of Housing and Urban Development Washington, D.C.*, HUD CLIPS (Mar. 30,

the repositories is commonly referred to as "raw data," whereas the data in an RMCR is often referred to as "full factual" or "reinvestigated" data. In 1988, Fannie Mae published the most comprehensive source for finding the specific requirements of the RMCR documentation procedures.[58] This outline by Fannie Mae concluded a collaborative effort by Fannie Mae, Freddie Mac, HUD, the Federal Housing Administration (FHA), the United States Department of Veterans Affairs (VA) and the Farmers Home Administration (FmHA) to reconcile each of their specific RMCR guidelines into a standard format that would be uniform across all entities for residential mortgage loans.

Some highlights of this reconciliation of the required procedures include:

- Removal of all duplicate account listings;
- All balances reported within 90 days;
- Addition of any accounts listed in the loan application not found in the national bureau records;
- Listing of all inquiries for the past 90 days;
- Verification of employment for two years;
- Update on all public records;
- Consumer interview to assure completeness of report; and
- Statement certifying the report meets these standards.[59]

Fannie Mae also clearly stated:

> The preparation of a Residential Mortgage Credit Report requires research and quality control procedures that take time . . . to properly complete. Credit reports that are rushed through to completion are more likely to have errors and omissions and may not include research routines that are necessary to comply with these requirements. Reports generated in this manner are unacceptable.[60]

In the late 1980s, one notable lender negotiated its way out of following these guidelines. This lender was CitiCorp Mortgage. CitiCorp was aggressively trying to become the nation's largest mortgage lender, and decided that cutting corners in many areas would advance its goal of gaining market share. One such shortcut was the abandonment of the RMCR standards in search of lending speed and cost savings. The result was more than $200

1988), http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/88-8ml.txt.

58. *See generally* FANNIE MAE, ANNOUNCEMENT NO. 88-05 (Mar. 22, 1988) (amending residential mortgage-credit-report standards).

59. *See id.* at 3-4.

60. *Id.* at 2.

million in mortgage losses, a staggering number in the early 1990s. The Comptroller of the Currency cited "sloppy practices that exposed the banking company to excessive risk" as a cause of the losses at CitiCorp Mortgage.[61]

The Comptroller of the Currency's findings regarding the CitiCorp Mortgage losses were not the only warning signs. In addition to the previously mentioned study conducted by NAICRA showing disparities between RMCR and the tri-merge, one of the oldest members of the industry also raised serious considerations about the tri-merge's ability to adequately document consumer credit for mortgage lending.[62] Despite the opposition to this transition, including Commonwealth's ninety-year industry perspective, Fannie Mae and Freddie Mac abandoned the RMCR. In doing so, they almost entirely eliminated the requirement list they had previously reconciled with the entire mortgage industry, in their quest for a cheaper, faster credit report that fit the automated technological solutions being applied to mortgage underwriting.[63] This background should be considered when reviewing the symposium materials from the panel on mortgages, medical debt, and collections, as these are all areas in which loss of the RMCR plays a role. Considering the RMCR process's accuracy protections, consumer education, and data completeness, one must question whether the housing crisis would have been as severe if the RMCR were still the standard in mortgage-credit reporting. The NCRA renewed questions about the quality of the tri-merge as early as 2001, particularly in the predatory and subprime lending debate,[64] but these questions were dismissed by industry participants now known for major contributions to the ultimate collapse of the housing market. Now, post-financial-crisis lending is very restrictive, only serving those with excellent credit. To safely expand that narrow credit scope to many deserving Americans, and to avoid the pitfalls associated with the limited pre-crisis credit documentation, perhaps some of the RMCR safeguards should be added back into the system.

Tenant screening is the term for providing consumer reports to property managers and landlords. Tenant reports provide the credit and criminal-history review of consumers applying for residence in multi-family housing and rental units. This submarket of consumer reporting is also dominated by resellers and is frequently misunderstood. These resellers are commonly referred to as tenant- or resident-screening companies, and they typically offer multiple

61. *See* Michael Quint, *Citicorp Criticized on Mortgages that Expose It to Too Much Risk*, N.Y. TIMES, Sept. 3, 1992, http://www.nytimes.com/1992/09/03/business/citicorp-criticized-on-mortgages-that-expose-it-to-too-much-risk.html.

62. *See generally* COMMONWEALTH INFO. SERVS., INC., SPECIAL REPORT: MERGED INFILE -VS- RESIDENTIAL MORTGAGE CREDIT REPORT.

63. *See* Kenneth R. Harney, *Many Big Lenders Plan to Switch to Quick, Electronic Credit Evaluations*, WASH. POST, Feb. 12, 1994, at F3, F5.

64. *See generally* NAT'L CREDIT REPORTING ASS'N, INC., POSITION AND VIEWS ON PREDATORY AND SUB-PRIME MORTGAGE LENDING (Aug. 2001).

report options as well as additional products and service "add-ons" such as: verification of employment, verification of income, additional credit data (in case the original repository had no record on the applicant), criminal history searches, and forcible detainer (unlawful detainer) records searches. Forcible detainers or eviction records are a type of public record not commonly found in the national credit repositories, and they are of unique importance to property managers because they specifically pertain to the potential tenant's relationship with previous property managers.

Finally, and perhaps most importantly, the reseller consumer reporting agencies that specialize in this area also offer the property manager and the consumer an alternative gateway for filing data-accuracy disputes. Disputes filed during this process with the reseller are often handled at the local or regional level and can be resolved on a timeline more conducive to the modern-day needs of all parties involved, especially for individuals in the midst of residence relocation.

One of the greatest debates in this industry, and one that was addressed in the symposium research on protected classes, was also directly addressed by HUD when it issued a new rule on the "Discriminatory Effect," concerning the disparate impact of the use of consumer reports for rental applications.[65] This new fair-housing disparate-impact rule may cause problems for landlords during the screening process. The new rule creates a provision entitled "Discriminatory effect prohibited," which defines "discriminatory effect" as situations in which a facially neutral (i.e., not discriminatory) housing practice can become discriminatory if it "actually or predictably" has an effect on a group of persons that are members of a protected class.[66] HUD will provide support for private or governmental plaintiffs challenging housing or mortgage-lending practices that have a disparate impact on protected classes of individuals, even if the practices are facially neutral and nondiscriminatory, with no evidence that the practice was motivated by discriminatory intent.

The new rule adopts a three-step, burden-shifting approach to determine liability under a disparate-impact claim.[67] Once a practice has been shown by the plaintiff to have a disparate impact on a protected class, the "defendant has the burden of proving that the challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests . . . ."[68] Many people would consider this elucidation to set a higher standard than the usual business justification that defendants typically are expected to meet. Even if the defendant meets this test, the plaintiff could still prevail by demonstrating

65. *See* Implementation of the Fair Housing Act's Discriminatory Effects Standard, 78 Fed. Reg. 11,460, 11,481-82 (Feb. 15, 2013) (codified at 24 C.F.R. pt. 100).

66. *Id.* at 11,482.

67. *See id.*

68. *Id.*

that these legitimate, nondiscriminatory interests could be served by a policy or decision that produces a less discriminatory effect.

There is no debate about the negative impact of discrimination. There is, however, a legitimate concern about the safety of innocent tenants, the employees who work at the property, the community at large, and the financial stability of the property owners. These issues of safety and financial security must also be addressed. What higher standard of business justification is needed than allowing property managers to prohibit previous sex offenders from seeking residence in multifamily housing complexes catering to families, the handicapped, or the elderly? Many communities have "nuisance property ordinances" that hold rental property owners accountable for the misdeeds of their tenants. For example, a Milwaukee, WI, nuisance ordinance has enforcement provisions that are triggered by repeat law-enforcement activity, even without arrest or conviction of the tenant or invitee.[69] Similar statutes exist in various municipalities throughout the United States.

On the Federal level, HUD's *Housing Choice Voucher Program Guidebook* sets forth generalized guidelines for the exclusion of consumer participation in publically funded housing for various criminal offenses, which often exceeds the exclusions in the private sector.[70] Chapter 5.7 of the current document provides that "[i]n determining whether to deny assistance based on drug-related cirminal [sic] activity or violent crimial [sic] activity, the PHA [Public Housing Authority] may deny assistance if the preponderance of evidence indicates that a family member has engaged in such activity, regardless of whether the family member has been arrested or convicted."[71] Similar language is repeated throughout the document and is seemingly contradictory to HUD's proposed rule.

It seems only reasonable that part of HUD's new rule would provide property owners with some bright-line guidance, establishing what background-screening criteria and methods will remain acceptable, as well as protections from potentially conflicting federal and local requirements. HUD finalized this rule as of February 15, 2013, with prohibitions blocking property managers from using this data. HUD has failed, however, to provide property owners and managers with any type of hold-harmless protections, which would shield them from potential claims brought by residents, as well as by state and local governments. It is unreasonable for HUD and other governmental agencies to take both sides of the same issue. It is also unreasonable for HUD

69. *See How Department of Neighborhood Services and Milwaukee Police Department Deal with Chronic Nuisance Complaints: Milwaukee's Chronic Nuisance Property Code*, CITY OF MILWAUKEE, http://city.milwaukee.gov/ChronicNuisance3701.htm (last visited Nov. 10, 2013).

70. *See Housing Choice Voucher Program Guidebook*, HUD, http://portal.hud.gov/hudportal/HUD?src=/program_offices/public_indian_housing/programs/hcv/forms/guidebook (last visited Nov. 10, 2013).

71. HUD, HOUSING CHOICE VOUCHER PROGRAM GUIDEBOOK, CHAPTER 5: ELIGIBILITY AND DENIAL OF ASSISTANCE 5-37 (Apr. 2001), http://portal.hud.gov/hudportal/documents/huddoc?id=DOC_11749.pdf.

to create different standards for private rental property versus properties receiving public assistance. The situation is now inequitable, and it will likely cause property owners and managers to incur unnecessary costs and harm. Just as HUD is considering the unintended consequences of screening, referred to as disparate impact, it must balance this with the fact that individuals do exist who have proven, by their own actions (as documented by our judicial system's records), that they disrupt communities and cause harm to others.

Another symposium subject of recent, significant debate is the use of credit information in employment screening and, by extension, pre-employment screening. These are the terms commonly associated with the act of providing consumer reports to employers as part of the hiring process. The reports used for employment seldom use credit information, despite popular opinion and current media activity. Resellers, referred to as employment-screening companies, also dominate this market. They provide background verifications and often have subsidiaries that are private investigators. This segment of consumer reporting offers the greatest variety of data options for consumer reports to cover the most varied risks. Multiple report options are common, featuring a wide variety of additional products and services used by the employer. Employers match report options and search items to the specific needs and risks associated with the various employment classifications within the company. Examples of these "add-ons" include: verification of employment, education, certifications, or professional licenses; criminal-history searches; and driving records. Employment screeners often partner with medical providers and laboratories in order to incorporate substance-abuse testing into the reports. All of this information is provided by the employment-screening companies in a technological format, flexible enough to interface with multiple types of software applications used by employers for compliance with hiring regulations.

One of the most overly reported stories of the past year regarding credit reporting is about the use of credit scores in employment. Recent article headlines on this topic include *Credit Scores and Employment Screening: Dispelling the Credit Myth of the Decade*[72] and *Want a Job? Raise Your Credit Score*.[73] Raising your credit score is always a good idea and, as the Forbes article points out, the use of credit in employment is allowed under federal law, but the use of credit scores is not.[74] In early 2012, John Ulzheimer of Credit Sesame solicited public statements from each of the repositories about the myth

72. *See* John Ulzheimer, *Credit Scores and Employment Screening: Dispelling the Credit Myth of the Decade*, CREDIT SESAME (Feb. 29, 2012), http://www.creditsesame.com/blog/credit-scores-and-employment-screeningdispelling-the-credit-myth-of-the-decade.

73. *See* Chereen Zaki, *Want a Job? Raise Your Credit Score*, FORBES (Mar. 16, 2012), http://www.forbes.com/sites/chereenzaki/2012/03/16/want-a-job-raise-your-credit-score.

74. *See id.*

of using credit scores in employment screening.[75] Rod Griffin, Director of Public Education for Experian, stated: "Credit scores are never used for employment purposes."[76] The Equifax spokeswoman agreed, stating: "Federal law allows potential and current employers to view a modified version of your credit report. Credit scores are not sold for employment screening purposes."[77] Clifton O'Neal, Senior Director of Corporate Communications for TransUnion, reported: "TransUnion is not aware of any such instances and TransUnion does not provide credit scores for employment purposes."[78] I personally contacted some NCRA members who provide employment-screening reports, in order to research this issue firsthand, after discussing the subject with a member of the White House advisory council in September 2012. In every conversation, the response was 100% conclusive that it was not even possible for any employer these NCRA members serviced to obtain a credit score through the employment-screening systems.

So, what accounts for this disconnect between perception and reality? Much of it can be attributed to semantics, confusion prompted by the required consumer disclosures, and mass marketing. In recent years the credit-reporting industry has been mass marketing credit reports to consumers, with an emphasis on individuals knowing their credit scores, utilizing a variety of advertising vehicles. When an applicant for a job signs the federally required FCRA disclosure for job applicants allowing the potential employer to conduct a background search, it is possible that the applicant automatically thinks "credit score" due to the exposure of the credit-score advertising.

The FCRA has stringent and detailed policies regarding the use of consumer reports by any type by employers. Employers must follow these guidelines carefully *before* they use consumer reports, whether credit information is part of the report or not, when making hiring or other employment decisions. The FCRA guidelines also offer strict consumer notification and disclosure requirements relating to an employer's use of consumer reports and credit before requesting a credit report. These disclosures require employers to tell consumers that a credit check will be requested, and employers must obtain employees' consent in order to obtain the credit information.[79] Also, before obtaining a credit report, the employer must certify to the provider of the report that the employer has a permissible purpose for obtaining the information, that the employer will comply with the FCRA's disclosure, authorization, and adverse-action provisions, and that the employer will not use "information from the consumer report . . . in violation of any applicable Federal or State equal

75. *See* Ulzheimer, *supra* note 72.
76. *Id.*
77. *Id.*
78. *Id.*
79. *See* 15 U.S.C. § 1681b(b)(2)(A) (2012).

employment opportunity law or regulation."[80] I believe that the FCRA disclosure may be a main source of confusion. The employer, "before taking any adverse action based in whole or in part on the report," must follow a two-step adverse-action process which requires that the consumer: (1) be given a copy of his or her report and a copy of the Federal Trade Commission's "Summary of Your Rights Under the Fair Credit Reporting Act"; and (2) be told of his or her right to dispute the accuracy or completeness of information in the report prior to adverse action being taken.[81]

Considering the legal responsibilities on employers, they are covering their exposure by using broad disclosures to limit their FCRA liability. When the applicant does not get hired, and reads these disclosures including the term "credit," many may assume credit scores came into play as the reason they were not hired. Combine this with the fact that many consumer reporting agencies are providing all types of background checks to verify previous employment history, criminal records, and other types of background information the employer requests, often designed to meet the specific needs of multiple types of positions within a company. For example, the employer may have several different types of employment-screening reports in use, in order to cover all aspects of negligent-hiring risk. Maintenance and warehouse staff require different background checks than office personnel, sales representatives with company cars, and accounting personnel with access to corporate funds. For the accounting personnel with access to corporate funds, the Equal Employment Opportunity Commission (EEOC) guidelines would clearly allow the use of credit information as part of the employment-screening process.[82] For the other positions it would depend on their responsibilities and/or access, or it may be clearly disallowed without potential for discrimination issues to be raised.

It would be very common for the human resources associates in a situation like this to use a general FCRA disclosure form that will provide blanket coverage for all possible hiring scenarios. Thus, when an applicant signs the document that allows the credit report to be accessed as part of the process, in reality that employer may only use credit for select positions within the company. Nevertheless, because all of the applicants are signing the same blanket disclosure document (typically without much explanation as to its use), it helps to perpetuate the myth about how often credit reports are used in hiring decisions.

For further information to quantify this, NCRA members ran some statistics

80. *Id.* § 1681b(b)(1)(A).

81. *Id.* § 1681b(b)(3).

82. *See Pre-Employment Inquiries and Credit Rating or Economic Status*, U.S. EQUAL EMP. OPPORTUNITY COMMISSION, http://www.eeoc.gov/laws/practices/inquiries_credit.cfm (last visited Nov. 10, 2013) (noting exception if credit information "is essential to the particular job in question").

in September 2012 about the use of credit information in employment reports.[83] The sample period was January 1, 2012 through September 1, 2012. Out of 746,349 consumer reports provided for employment screening purposes, only 9.2% included a credit report. It should be noted that the sample group contained a high percentage of clients who fell into an industry that is highly regulated, and allowed under the EEOC guidelines for the use of credit reports in employment decisions,[84] due to the risk associated with the jobs they offer, and are typically higher in percentage of credit use than the average business. Also confirmed, of the 9.2%, absolutely no credit scores were provided. It is imperative to stress, it would not have even been possible to provide a credit-bureau score if the employer had requested it.

This correlates with research conducted by the Society of Human Resource Management (SHRM), which listed the typical position of credit reports in employment decisions. While 13% of companies claimed they used credit reports for all positions, the breakdown varied from 4% to 91% across eleven different job classifications.[85]

On the subject of credit scores, we will not go into detail on how scores are calculated and the methods used to weigh the consumers' data, because this is covered very well in the symposium papers by the scoring modelers themselves. We will mention, however, that since Bill Fair and Earl Isaac founded the Fair Isaac Corporation (FICO) in 1956,[86] credit scores have been very effective in predicting risk on a macro level. After slow adoption rates in the early years as the repository systems developed, the scores became more developed, and score use expanded in the 1970s. Use of credit scores in other types of risk underwriting also expanded.[87] When the actuary number crunchers responsible for forecasting risk-reward benefits have decades to evaluate the forecast, obtain actual results, and expand the use of scores based on those findings, this is proof that credit scoring works, or its use would not have continued.

On the other hand, from the micro perspective of specific cases, there are examples of situations where the scores have caused problems in the system, especially when the scoring data contains errors or omissions. One of the greatest problems regarding credit scores occurs when lenders forget that the score is only a tool to assist the assessment of risk. Too often lenders make the

83. This Article contains internal NCRA study results not previously published.

84. *See id.*

85. *See Background Checking: The Implications of Credit Background Checks on Hiring Decisions*, SOC'Y FOR HUM. RESOURCE MGMT., at slides 6-7 (Aug. 2010), *available at* http://www.shrm.org/Research/SurveyFindings/Articles/Pages/BackgroundCheckingImplications.aspx.

86. *See History*, FICO, http://www.fico.com/en/Company/Pages/history.aspx (last visited Nov. 10, 2013).

87. *See* BD. OF GOVERNORS OF THE FED. RESERVE SYS., REPORT TO THE CONGRESS ON CREDIT SCORING AND ITS EFFECTS ON THE AVAILABILITY AND AFFORDABILITY OF CREDIT 3-4 (Aug. 2007), *available at* http://www.federalreserve.gov/boarddocs/rptcongress/creditscore/creditscore.pdf.

score the driving force in the decision; a single point can mean the difference between getting the loan or not, and can determine what price the consumer pays in interest. Credit scores should not override other risk elements, and they should also not derail potentially good loans because of missing or incorrect data in the score calculation and unwillingness by lenders to underwrite around the score when those missing elements are documented.

A consumer warning about scores: A case can be made that consumers should not get caught up with fascination about their credit scores and should not purchase credit scores. Most of the credit scores marketed to consumers are designed for sale to consumers. These are not usually the scores used by lenders. Even if the consumer gets a credit score used by lenders, there are so many models of credit scores that the chances of getting the version of the score model used by a creditor for an auto or mortgage transaction is unlikely at best. It is actually impossible to get a version of the score used by mortgage lenders based on your Experian credit information, because Experian has not allowed consumers to access its data for FICO score disclosures since 2009.[88] The FICO score is the score model required by GSEs and HUD for mortgage underwriting, but consumers can only use a simulation that may be close to the FICO score.

Multiple versions of the FICO score have been developed and are in active use at each of the three national repositories. There are also dozens of specialty versions of credit scores that are honed for specific industries. Additionally, there is the newer VantageScore. VantageScore is owned by a joint venture of the three repositories and competes with FICO. VantageScore has become the dominant score used in credit-card underwriting and other personal-finance applications; however, it is not used in mortgage lending at this time.

Depending on the lender and the type of credit applied for, the lender may use: the basic FICO or VantageScore score, each with its own point scale; a different point scale; or a specialty score designed for auto loans, credit cards, or personal loans, specifically designed to highlight the needs of each industry. Regardless, the lender is not going to use one of the scores available to consumers. So, when a consumer learns that he has a 730 credit score, what does that really mean? If the 730 is a real FICO score, then the consumer should be in a favorable position for most credit applications; however, if the 730 is a VantageScore (which had a different score range that went to 1000, until the March 2013 release of VantageScore 3.0,[89] which operates on a similar scale to FICO), then 730 may be a problem, and the consumer could incur higher interest rates. This is why it has been suggested that consumers

88. *See Experian and myFICO.com*, EXPERIAN (Feb. 19, 2009), http://www.experian.com/blogs/ask-experian/2009/02/19/experian-and-myfico-com.

89. *See How It Performs*, VANTAGESCORE, http://www.vantagescore.com/model-performance (last visited Nov. 10, 2013).

should not purchase their credit scores; it is almost impossible to get a score that will be the same score used for their next credit transaction.

Considering all of this information about scores, and the problems with financial literacy for too many Americans, would it not be better for the consumers to focus on the credit report data than the score? Consumers mostly know whether they sent their payments on time or not. They usually know, or can find out if the contents of their credit reports are being reported completely and accurately. This is the most important area to expend effort, because consumers cannot do anything to change the algorithm of the scoring models. If consumers spend their efforts understanding their reports and ensuring that the scoring systems are using accurate data, then their scores will be a forthright reflection of the consumer's creditworthiness, regardless of what scoring system is ultimately used.

At this point, a movie equivalent to a flashback is needed. A quick peek into the history of the credit-reporting industry and how these massive databases came into being will be helpful to address a couple of remaining topics. Many believe that successful improvement begins with an understanding of the history and evolution of the thing to be improved.

The United States' credit-reporting industry began on the commercial side. Reporting credit quality of business entities began in the 1830s, with the first commercial agency—the origin of Dun & Bradstreet—established in 1841.[90] The consumer credit reporting industry began in the 1860s and was primarily a local, merchant-based bureau, documenting consumers with whom merchants needed to be careful when extending credit. One of the most notable merchant-based bureaus was created by Cator and Guy Woolford, two brothers from Chattanooga, TN. In 1899, they started a company in Atlanta, GA, called the Retail Credit Company, selling a "Merchants Guide" to local grocers, which has now grown into the Equifax repository.[91] Another industry giant started small in 1897, with the Dallas merchant guide *The Red Book*. Created by J.E.R. Chilton and advanced by later generations of the Chilton family, it grew into one of America's most successfully run organizations. The focus of the 1986 book, *Pioneers of Excellence: A History of the Chilton Corporation*, details the efforts taken by the Chilton credit-reporting division to be the industry leader in compliance with the FCRA.[92] Chilton was sold to Borg-Warner Corporation in 1986, then to TRW Inc. for $360 million in 1988,[93] and

90. *See Dun and Bradstreet Company History*, D&B, http://www.dnb.com/company/history.html (last visited Nov. 10, 2013).

91. *See* Andy Serwer, *Credit Bureaus Exposed: The Companies That Determine Your Ability To Get a Loan Have Dabbled in Everything from Handbags to Animal Husbandry. Scared Yet?*, FORTUNE, Apr. 28, 2003, http://money.cnn.com/magazines/fortune/fortune_archive/2003/04/28/341730/index.htm.

92. *See generally* WILLIAM SIMON, PIONEERS OF EXCELLENCE: A HISTORY OF THE CHILTON CORPORATION (1986).

93. *See* Julia Flynn Siler, *Company News; TRW Agrees to Buy Borg-Warner's Chilton*, N.Y. TIMES, Mar.

is now known as Experian. Experian has been owned by Great Universal Stores (GUS) of Great Britain since 1996, when GUS wanted a United States presence in its growing international-credit-reporting business. The growing value of the industry was shown in Experian's $1.7 billion purchase price.[94]

Local credit bureaus thrived from the late 1800s through the 1970s, before the mega databases were created. At the peak, more than 2000 local credit bureaus existed in the United States. Then, a new business model was developed, to modernize and build a national credit-reporting system by affiliating a group of these local, merchant-owned credit bureaus. This new concept allowed the local, independent companies to affiliate under a universal computer system, creating a nationwide database, yet they remained independently owned and operated. The affiliated business model was developed in the 1960s by another industry pioneer, Robert K. Pinger, president of the Credit Bureau of Greater Houston. Pinger embraced the new technology, computerizing and linking the offices of the Credit Bureau of Greater Houston with its Dallas offices, paving the way for the computer connection of the affiliated group of credit bureaus on a nationwide basis.[95] The Credit Bureau of Greater Houston became the Associated Credit Services, one of five companies that would ultimately use this affiliation business model, the foundation of the modern credit repositories.

Daniel B. Klein provided a detailed history of the credit-reporting industry and its important connections to free speech in his article, *Credit-Information Reporting: Why Free Speech Is Vital to Social Accountability and Consumer Opportunity*.[96] It is important to remember these ties, and their connection to the very foundation of this nation, as we focus on the issues associated with the U.S. credit system. Through the massive changes Americans brought to our nation, the need for an evolving credit-reporting system grew and changed as well. The system implicates values including free speech and the need to provide a basis for personal accountability for one's actions, which have remained constant over time. Without this accountability, convenient access to credit and the vast majority of Americans' ability to obtain credit could be jeopardized.

What is the reason for this history lesson? There seems to be a connection between the industry's consolidation and some of the problems we are

22, 1988, http://www.nytimes.com/1988/03/22/business/company-news-trw-agrees-to-buy-borg-warner-s-chilton.html.

94. *See Large British Retailer To Buy U.S. Credit-Data Company*, N.Y. TIMES, Nov. 15, 1996, http://www.nytimes.com/1996/11/15/business/large-british-retailer-to-buy-us-credit-data-company.html.

95. *See* James J. Kilpatrick, *Computers and Credit*, TUSCALOOSA NEWS, Mar. 28, 1968, at 4, *available at* http://news.google.com/newspapers?nid=1817&dat=19680328&id=k_4cAAAAIBAJ&sjid=OJsEAAAAIBAJ&pg=6828,5229770.

96. *See generally* Daniel B. Klein, *Credit-Information Reporting: Why Free Speech Is Vital to Social Accountability and Consumer Opportunity*, 5 INDEP. REV. 325 (2001), *available at* www.independent.org/pdf/tir/tir_05_3_klein.pdf.

currently discussing. While the industry's consolidation brought better overall point-of-sale technology and, ultimately, three complete, competing national databases for most transactions, the local credit bureaus were eliminated. Some transactions, specifically mortgage credit, now have monopoly forces in play with questionable outcomes. This elimination signaled the end of the connection to the consumer, the smaller creditors, and the information and services both provided, a subject of much debate within the sphere of accuracy.

The merchant-owned bureaus gave consumers the opportunity to work with a local person in order to resolve credit-reporting disputes, instead of the offshore call centers that are all too common today. The local credit bureaus also gave smaller creditors the opportunity to provide their data to the larger credit system. This allowed easier entry into the credit world for many consumers. The repositories typically require creditors to have a minimum of 250 to 500 active accounts in order to provide their data to the system. If the account goes into default, then the creditor sends it to a collection agency, which acts as an efficient, small credit-data aggregator. This provides a pathway for the negative accounts of smaller creditors into the system, while blocking the good accounts from smaller creditors. This disparity hits the hardest where smaller creditors dominate the market: inner-city neighborhoods and rural America. These locales serve niche markets, often overlooked by the national chains now offering the gateway to credit establishment that once was served by local credit bureaus.

In recent years there has been debate about the value of including alternative or nontraditional data in credit reports, in order to provide a better, more complete picture of the applicant. Alternative or nontraditional credit accounts are the names given to consumer credit accounts that that are not reported to the repositories, such as accounts from smaller creditors, which were lost from the database when the local credit bureaus went away. They can be documented in order to assist consumers who have little or no repository data with which to obtain credit.[97] The PERC has led several international studies and reports on this subject. The PERC's U.S. publications on the subject began in June 2005, with reports released between 2005 and 2012 including: *Giving Underserved Consumers Better Access to the Credit System: The Promise of Non-traditional Data*;[98] *Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit Using Alternative Data*;[99] *Using Non-traditional Data for*

97. *See Using Nontraditional Credit Information: Boon or Bane?*, NAT'L CONSUMER L. CENTER (June 2009), https://www.nclc.org/images/pdf/credit_reports/credit_reports_boon_bane.pdf.

98. *See generally* INFO. POLICY INST., POLITICAL & ECON. RESEARCH COUNCIL, GIVING UNDERSERVED CONSUMERS BETTER ACCESS TO THE CREDIT SYSTEM: THE PROMISE OF NON-TRADITIONAL DATA (July 2005), *available at* http://perc.net/wp-content/uploads/2013/09/nontrad.pdf.

99. *See generally* POLITICAL & ECON. RESEARCH COUNCIL & BROOKINGS INST. URBAN MKTS. INITIATIVE, GIVE CREDIT WHERE CREDIT IS DUE: INCREASING ACCESS TO AFFORDABLE MAINSTREAM CREDIT USING ALTERNATIVE DATA (Dec. 2006), *available at* http://perc.net/wp-content/uploads/2013/09/alt_data.pdf.

Underwriting Loans to Thin-File Borrowers: Evidence, Tips and Precautions;[100] *You Score, You Win: The Consequences of Giving Credit Where Credit Is Due*;[101] *New to Credit from Alternative Data*;[102] *Credit Reporting Customer Payment Data: Impact on Customer Payment Behavior and Furnisher Costs and Benefits*;[103] and *A New Pathway to Financial Inclusion: Alternative Data, Credit Building, and Responsible Lending in the Wake of the Great Recession*.[104] These reports, studies, and papers promote the advantages of using alternative data in all types of lending.

The PERC's most recent alternative or nontraditional credit research focuses on the inclusion of telecommunications and utility payments in the credit-reporting system. Their research attempts to quantify the consumer-advocacy concerns regarding this issue. Using utility information could hurt consumers in states that prohibit gas or electric companies from shutting off the heat in winter months to vulnerable consumers for failing to pay their bills. Financially distressed consumers could, and should, be prioritizing payment of their bills knowing their utilities cannot be shut off, so that they can afford to pay for food or other critical needs. Also, Low Income Heating Assistance Programs (LIHAPs) in some states actually require consumers to receive a shut-off notice before they can receive assistance. Reporting utility information means that these consumers will not be able to access LIHAP assistance without damaging their credit records.[105]

The 112th Congress attempted to pass *The Credit Access and Inclusion Act*, which would have required the reporting of utility and telecommunications payment data to the repositories.[106] The sponsors of this bill were clearly

100. *See generally* Michael A. Turner & Amita Agarwal, *Using Non-traditional Data for Underwriting Loans to Thin-File Borrowers: Evidence, Tips and Precautions*, 1 J. RISK MGMT. FIN. INSTITUTIONS 165 (2008), *available at* http://perc.net/wp-content/uploads/2013/09/pp165-80.pdf.

101. *See generally* MICHAEL TURNER ET AL., POLITICAL & ECON. RESEARCH COUNCIL, YOU SCORE, YOU WIN: THE CONSEQUENCES OF GIVING CREDIT WHERE CREDIT IS DUE (July 2008), *available at* http://perc.net/wp-content/uploads/2013/09/web_layout-you-score.pdf.

102. *See generally* MICHAEL A. TURNER ET AL., POLITICAL & ECON. RESEARCH COUNCIL, NEW TO CREDIT FROM ALTERNATIVE DATA (Mar. 2009), *available at* http://perc.net/wp-content/uploads/2013/09/New_to_Credit_from_Alternative_Data_0.pdf.

103. *See generally* MICHAEL TURNER ET AL., POLITICAL & ECON. RESEARCH COUNCIL, CREDIT REPORTING CUSTOMER PAYMENT DATA: IMPACT ON CUSTOMER PAYMENT BEHAVIOR AND FURNISHER COSTS AND BENEFITS (Mar. 2009), *available at* http://perc.net/wp-content/uploads/2013/09/bizcase_0.pdf.

104. *See generally* MICHAEL A. TURNER ET AL., POLITICAL & ECON. RESEARCH COUNCIL, A NEW PATHWAY TO FINANCIAL INCLUSION: ALTERNATIVE DATA, CREDIT BUILDING, AND RESPONSIBLE LENDING IN THE WAKE OF THE GREAT RECESSION (June 2012), *available at* http://perc.net/wp-content/uploads/2013/09/WEB-file-ADI5-layout1.pdf.

105. *See generally* MICHAEL TURNER ET AL., POLITICAL & ECON. RESEARCH COUNCIL, THE CREDIT IMPACTS ON LOW-INCOME AMERICANS FROM REPORTING MODERATELY LATE UTILITY PAYMENTS (Aug. 2012), *available at* http://perc.net/wp-content/uploads/2013/09/ADI_ML_Impacts.pdf.

106. *See* The Credit Access and Inclusion Act, H.R. 6363, 112th Cong. (2012), *available at* http://www.govtrack.us/congress/bills/112/hr6363/text.

looking at the legislation from the PERC's perspective.[107] Gathering large databases certainly works for the modern repositories' business models, as reflected in the highly concentrated allocation of data from the top 100 data providers.

The PERC is not alone in the quest to use alternative data in lending. HUD addressed the subject in a letter from Brian D. Montgomery, Assistant Secretary for Housing-Federal Housing Commissioner. In this letter, the FHA announced that it would "prefer all nontraditional credit references be verified by a credit bureau," and that FHA approved lenders may use a credit bureau to develop a credit history for borrowers with no or little traditional credit using a "bill payment history, as well as a score" based on rental, utility, and other "common recurring non-reporting bill payments."[108]

A totally overlooked portion of federal law actually requires lenders to consider alternative credit when presented by consumers as part of their transaction. Pursuant to the Equal Credit Opportunity Act (ECOA), all consumers have a legal right to have their bill payments taken into consideration to evaluate their creditworthiness when traditional credit reports and scores are not reporting their activity. Section 202.6(b) of the ECOA regulations provides in part:

> (6) Credit history. To the extent that a creditor considers credit history in evaluating the creditworthiness of similarly qualified applicants for a similar type and amount of credit, in evaluating an applicant's creditworthiness a creditor shall consider:
>
> > (i) The credit history, when available, of accounts designated as accounts that the applicant and the applicant's spouse are permitted to use or for which both are contractually liable;
> >
> > (ii) On the applicant's request, any information the applicant may present that tends to indicate the credit history being considered by the creditor does not accurately reflect the applicant's creditworthiness; and
> >
> > (iii) On the applicant's request, the credit history, when available, of any account reported in the name of the applicant's spouse or former spouse that the applicant can demonstrate accurately reflects the applicant's creditworthiness.[109]

107. *See* Keith Ellison & Jim Renacci, *Bringing 'Credit Invisibles' Out of the Dark: The Economy Will Benefit If On-Time Cellphone and Utility Payments Count*, WALL ST. J., Sept. 20, 2012, http://online.wsj.com/article/SB10000872396390443995604578003872577102686.html.

108. *See* Letter from Brian D. Montgomery, Assistant Sec'y for Hous.—Fed. Hous. Comm'r, U.S. Dep't of Hous. & Urban Dev., to All Approved Mortgagees, Nontraditional Credit Verification and Evaluation 2 (Apr. 29, 2008).

109. 12 C.F.R. § 202.6(b)(6) (2013).

Even though this is the law, the issue is how to get the lender to actually consider it. Michael G. Nathans's *Shoe Box Credit* outlines one strategy for this, which is to document the alternative data.[110] Even if you get the lender to look into the "shoe box," however, the question remains: What does "consider" really mean? For mortgage borrowers, there was a safety net in the form of the RMCR guidelines, which ensured that these missing accounts were documented. While this is certainly a pathway to providing a credit profile for those without a credit history, the symposium materials from Tom Feltner of the Woodstock Institute, Glen Canner of the Federal Reserve Board, and others addressing the impact on protected classes and disparate impact raise the question of whether the addition of telecom and utility payments is truly a replacement for the neighborhood used car lot, the local furniture store, the local service providers, and other small creditors that extend actual credit terms and are not getting into the system.

Obviously, this much debate and the attempts at legislation forcing the reporting of telecommunications and utility credit data into the bureaus suggests at least one negative, unintended consequence of the consolidation. Another is lack of competition. Rarely has reduction of competition been good for consumers; this is why federal oversight is required when industries move toward high concentration of market power. Despite historic antitrust issues in the consumer reporting industry starting in 1933,[111] the consolidation was allowed, and a monopoly was granted. The quasi-government mortgage-industry giants Fannie Mae and Freddie Mac eliminated the RMCR—which required data from two of the three (and in earlier years, two of the five) national repositories as well as other safeguards—for the totally automated, score-driven tri-merge report. With this change, each of the repositories was effectively granted monopoly status for its data in the report for every mortgage loan originating in the United States, eliminating any need for price competition. This has been challenged in courts and is still moving through the federal judiciary in a California suit,[112] as resellers in mortgage and tenant screening are now facing a track of elimination reminiscent of that faced by the affiliated credit bureaus a couple of decades ago. Because the industry is still consolidating, perhaps it is time for the Justice Department to review the market again.

With so many issues at hand, we aim to achieve a sense of balance. Balance between work and family life. The balance of power carefully designed by our forefathers and spelled out in the U.S. Constitution. The need for balance in

110. *See generally* MICHAEL G. NATHANS, SHOE BOX CREDIT (2011).

111. *See* United States v. Associated Credit Bureaus, Inc., 345 F. Supp. 940, 941 (E.D. Mo. 1972) (discussing 1933 consent decree involving National Retail Credit Association's Sherman Act violation).

112. *See Credit Reporting Agency Files Antitrust Class Action Against Experian and CoreLogic for Collusion*, PR NEWSWIRE (July 10, 2012), http://www.prnewswire.com/news-releases-test/credit-reporting-agency-files-antitrust-class-action-against-experian-and-corelogic-for-collusion-161971435.html.

the consumer-reporting industry is just as crucial. The balance is currently skewed, playing out in a way of eliminating industry segments in favor of the market power of a few, and a revised government review of this practice is needed. In the new regulatory position of the CFPB, it is imperative that they look at the balance of regulation between industry and consumer, as well as the balance of power within the industry itself. The balance between large and small providers is crucial, because this pertains to the quality of products and services delivered to the consumers on their most important life transactions.

In 1759, Adam Smith, the father of modern economics, wrote that human moral ideas and actions are an inherent aspect of nature, and that if people were left to their own free life and forbidden from force or fraud, mankind would create rich and fulfilling communities.[113] This was seventeen years before Smith wrote the epic *The Wealth of Nations*.[114] Prospective creditors, landlords, and employers need access to reliable data in order to make sure credit is available, rental housing is secured, and open employment opportunities are safely filled in a world scattered with unethical and sometime dangerous people. The ability to make informed decisions with proper guidance on how to utilize the information discovered to serve both the community and industry is critical. Without proper access to the data, uninformed decisions are bound to create new and potentially devastating problems. Consumer reporting provides a check and balance to those same theories dating back to Adam Smith, helping to hold mankind accountable to immoral financial and other acts that could undermine our economic prosperity and safety. The symposium articles in the following pages will help to provide improvement and better regulation of the industry, in order to maintain that ever-important balance.

113. *See generally* ADAM SMITH, THE THEORY OF MORAL SENTIMENTS (1759), *available at* http://www.stanford.edu/class/history34q/readings/Adam_Smith/Smith_MoralSentiment1.html.

114. *See generally* ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (1776).