The Misconception of the Consumer as a *Homo Economicus*: A Behavioral-Economic Approach to Consumer Protection in the Credit-Reporting System

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ABSTRACT

The significant increase in the number of consumer transactions, along with the expansion of information technology, has created massive amounts of detailed information on an individual's credit history. Consumer credit reporting agencies (CRAs) play an important role in this financial-information market.

Although the credit-reporting system has significant economic benefits, CRAs have a tarnished reputation as far as consumer protection is concerned. While making their business out of gathering, compiling, and analyzing consumers' information, CRAs generally do not have privity of contract with those very same consumers. Thus, the CRAs have little or no incentive to protect consumers' privacy and ensure the accuracy of every single credit report. Such lack of incentive has resulted in numerous consumer problems, including inaccuracies in credit reports and erroneous credit scores; infringement of consumers' right to privacy; contribution to the prevalence of identity theft; and the creation of a fertile ground for consumer manipulation through targeted marketing lists.

This Article suggests that the current regulatory system has been captivated by the misconception of the consumer as a *homo economicus*. Existing regulations have given consumers a significant role in facilitating the production of more accurate credit, envisioning rational, vigilant, and alert consumers who regularly monitor their credit reports, dispute errors, and opt out from marketing lists. Studies have shown, however, that consumers' rationality in decision-making is in fact doubtful, and so too is the justification of imposing monitoring responsibilities on consumers.

This Article challenges the economic-regulatory approach through the behavioral-economic approach—a relatively new model that aspires to explain consumers' biases and cognitive limitations, which are absent in the standard

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economic framework. This Article explores two potential consumer-protection mechanisms, drawn from the behavioral-economic framework: applying psychological tools, such as disclosure and framing, for a better-designed system; and enhancing consumer financial literacy.

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I. INTRODUCTION

Consumer credit availability in the United States has grown dramatically throughout the twentieth century. The significant increase in the number of consumer transactions, along with the expansion of information technology, has resulted in the creation of massive amounts of detailed information on an individual's purchasing and credit history.

Consumer credit reporting agencies (CRAs) play an important role in the financial information market.[1] These agencies collect, process, and analyze financial information received from various furnishers to create consumer reports and credit scores. Such consumer reports assist, among others, lenders, retailers, employers, and landlords in assessing consumers' creditworthiness. Major CRAs also offer personalized and demographic data to their clients for marketing purposes.

The credit-reporting system has significant economic benefits. It renders various financial and purchasing opportunities—such as credit, employment, housing, and insurance—more available and affordable to consumers.[2] CRAs have a tarnished reputation, however, as far as consumer protection is concerned. While making their business out of gathering, compiling, and analyzing consumers' information, CRAs generally do not have privity of contract with those very same consumers. Thus, CRAs have little or no incentive to protect consumers' privacy and ensure the accuracy of every single

1. This Article focuses on *consumer* credit reporting agencies, as opposed to *business* registries (such as Dun & Bradstreet) or credit rating agencies, which assign credit ratings for issuers (such as Moody's and Standard & Poor's).

2. *See* Daniel B. Klein, *Credit-Information Reporting: Why Free Speech Is Vital to Social Accountability and Consumer Opportunity*, 5 INDEP. REV. 325, 329 (2001), *available at* http://www.independent.org/pdf/tir/tir_05_3_klein.pdf.

credit report.[3]

This lack of incentive has caused numerous problems for consumers, including major inaccuracies in credit reports and erroneous credit scores; infringement of consumers' right to privacy by providing information with no permitted purpose under the law; contribution to the prevalence of identity theft; and the creation of a fertile ground for consumer manipulation through targeted marketing lists.[4] These problems can cause severe damage to consumers, who may be denied credit, employment, housing, and insurance. The situation is also potentially detrimental for lenders, who may extend underpriced credit to a consumer or reject a creditworthy borrower. Finally, the lack of CRA incentives to protect consumers' privacy and ensure reporting accuracy can generate a series of larger negative externalities, affecting the economy as a whole.

Since 1970, various regulatory efforts have been made to address these problems without undermining the voluntary nature of the credit-reporting system. Such regulatory attempts to protect consumers include, inter alia, entitling all consumers to one free annual credit report, implementing a dispute-resolution process to investigate and correct errors, and endowing consumers with the right to opt out of marketing lists.[5] Yet, despite these regulatory efforts, CRAs have failed to maintain accurate files, identity theft continues to be a growing phenomenon, and many consumers have been tempted to accept offers for excessive or unnecessary borrowing by prescreened solicitations.[6]

This Article suggests that the current regulatory system has been captivated by the misconception of the consumer as a *homo economicus*. Existing regulations have given consumers a significant role in facilitating the production of more accurate credit. The current system envisions rational, vigilant, and alert consumers, who regularly monitor their credit reports, dispute errors, and opt out of marketing lists. At the heart of this approach is the notion that consumers know their own credit history and are able to determine its accuracy at the lowest costs.[7] Moreover, rational consumers can decide whether it is worthwhile to incur the costs associated with monitoring credit reports and disputing errors. Studies have shown, however, that consumers' rationality in the decision-making process is in fact questionable, and so too is the justification for imposing monitoring responsibilities on consumers.[8]

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3. *See infra* Part II.C.

4. *See id.*

5. *See infra* Part II.D.

6. *See infra* Part II.C.

7. *See* Michael E. Staten & Fred H. Cate, *Does the Fair Credit Reporting Act Promote Accurate Credit Reporting?* 4-17 (Joint Ctr. for Hous. Studies, Working Paper BABC 04-14, 2004), *available at* http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/babc_04-14.pdf.

8. *See infra* Parts III-IV.

My objectives in this Article are twofold. The first objective is to challenge the *economic-regulatory* approach through the *behavioral-economic* approach—a relatively new model that aspires to explain relevant features of human behavior absent in the standard economic framework.[9] Research in behavioral economics has shown that people's preferences and decision-making processes are often different from the rational behavior expected from the *homo economicus*. Consequently, people sometimes fail to act in their own best interests and do not maximize their utility.[10] Part III will introduce three types of judgment errors that people are inclined to make. Part IV will explain how these errors are reflected in the credit-reporting industry, harming consumers, lenders, and the economy as a whole.

The second purpose of this Article is to explore different solutions that may fit into the behavioral-economic framework. Part V will analyze two potential consumer-protection mechanisms:[11] applying psychological tools, such as framing and defaults, for a better-designed system ("libertarian paternalism"[12]), and enhancing consumer financial literacy. This Article is the first to employ the behavioral-economic approach with respect to the credit-reporting system.

Because CRAs are a substantial part of the United States' society and economy, the debate over their operation is of utmost importance.[13] I hope that this Article will offer new insights into problems that may affect every consumer in the United States in the contemporary information age.

II. BACKGROUND: CREDIT REPORTING AGENCIES IN THE UNITED STATES

A. The Consumer-Credit-Reporting Industry

The first consumer CRAs in the United States emerged in the late nineteenth century, in the wake of the country's expansion and the subsequent increase in trading transactions. These private, for-profit firms commoditized borrower information and made it available to anyone for a price, whereas it was previously only available to members of closed networks.[14] CRAs applied the

9. *See* Peter Diamond & Hannu Vartiainen, *Introduction* to BEHAVIORAL ECONOMICS AND ITS APPLICATIONS 1, 1 (Peter Diamond & Hannu Vartiainen eds., 2007).

10. *See* Colin Camerer et al., *Regulation for Conservatives: Behavioral Economics and the Case for "Asymmetric Paternalism,"* 151 U. PA. L. REV. 1211, 1216-17 (2003).

11. *See generally* Howell E. Jackson, *Regulation in a Multisectored Financial Services Industry: An Exploratory Essay*, 77 WASH. U. L.Q. 319 (1999) (reviewing differences in regulatory structures across sectors of financial services industry); John Y. Campbell et al., *The Regulation of Consumer Financial Products: An Introductory Essay with Four Case Studies* (Harvard Kennedy Sch. Faculty Research, Working Paper Series No. RWP10-040, 2010), *available at* https://research.hks.harvard.edu/publications/getFile.aspx?Id=602 (considering vast array of regulatory tools regarding consumer financial products).

12. *See* Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism Is Not an Oxymoron*, 70 U. CHI. L. REV. 1159, 1160-63 (2003).

13. *See* Klein, *supra* note 2, at 329 (describing societal importance of credit bureaus).

14. *See* Rowena Olegario, *Credit Reporting Agencies: A Historical Perspective*, *in* CREDIT REPORTING SYSTEMS AND THE INTERNATIONAL ECONOMY 115, 118-19 (Margaret J. Miller ed., 2003).

information they collected to consumers' credit histories to assist lenders in evaluating credit risk, reducing the problems of adverse selection and information asymmetry between borrowers and lenders.[15] Simultaneously, the transparency of consumers' credit histories reduced consumers' "moral hazard," because delinquency with one lender could result in sanctions by other lenders as well.[16]

CRAs replaced the traditional letters of recommendation and other forms of gossip with standardized criteria for creditworthiness.[17] At their inception, in the absence of information pertaining to past financial behavior, CRAs relied on borrowers' characteristics, such as "honesty," "extravagance," and "energy," to determine creditworthiness.[18] This system was eventually accepted as useful by the end of the nineteenth century, despite initial misgivings about what many Americans perceived was an inquisitorial method of assessing creditworthiness.[19]

Consumer credit availability in the United States grew dramatically throughout the twentieth century. Barron and Staten attribute broader access to credit products to four factors: "[l]egal rules that permit the collection and distribution of personal credit data"; "[d]ramatic reductions in data processing costs and . . . improvements in the speed of data retrieval"; "[t]he development of statistical scoring techniques for predicting borrower risk"; and "[t]he repeal of legislated interest rate ceilings that had limited the ability of creditors to price their loan products according to risk."[20]

Indeed, the significant increase of consumer transactions and the expansion of information technology have resulted in the creation of massive amounts of detailed information about individuals' purchasing and credit histories. In this market of extensive financial information, CRAs play an important role. Information is provided to CRAs on a voluntary basis from sources such as: lenders of all kinds (including banks, credit card companies, mortgage

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15. *See* George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488, 489-92 (1970) (explaining adverse selection and information-asymmetry problems); *see also* Marco Pagano & Tullio Jappelli, *Information Sharing in Credit Markets*, 48 J. FIN. 1693, 1695-1710 (1993) (establishing research framework and international perspective on information asymmetry).

16. *See* Margaret J. Miller, *Introduction* to CREDIT REPORTING SYSTEMS AND THE INTERNATIONAL ECONOMY, *supra* note 14, at 1, 1-2.

17. *See* Olegario, *supra* note 14, at 121.

18. *See id.* at 125-31.

19. *See id.* at 131.

20. John M. Barron & Michael Staten, *The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience*, *in* CREDIT REPORTING SYSTEMS AND THE INTERNATIONAL ECONOMY, *supra* note 14, at 273, 284; *see* MARK FURLETTI, FED. RESERVE BANK OF PHILA., AN OVERVIEW AND HISTORY OF CREDIT REPORTING 3-6 (June 2002), http://www.philadelphiafed.org/consumer-credit-and-payments/payment-cards-center/pub lications/discussion-papers/2002/CreditReportingHistory_062002.pdf (providing history of credit-reporting companies); Robert M. Hunt, *Development and Regulation of Consumer Credit Reporting in the United States*, *in* THE ECONOMICS OF CONSUMER CREDIT 301, 307-13 (Giuseppe Bertola et al. eds., 2006) (discussing history of United States' consumer credit-reporting industry).

companies, and retail stores), employers, medical insurers, landlords, governmental agencies, and court records. Interestingly, this voluntary system evolved with almost no regulatory interference with regard to its main functions.[21]

Today, at least one credit report exists for every credit consumer in the country.[22] More than three million credit reports are issued every day, and over two billion items of information are added to these reports every month.[23] In addition to credit reports and credit scores, major CRAs also offer their clients personalized and demographic data for marketing purposes, called prescreening services.[24]

The consumer credit-reporting industry today is divided into large and small firms.[25] The three largest national agencies are TransUnion, Experian, and Equifax.[26] These highly automated agencies concentrate on large businesses that seek credit reports on a high-volume basis. There are also several agencies that serve particular niche markets, such as the Medical Information Bureau, which compiles health information of persons applying for life insurance; Telecredit, SCAN, and Chexsystems, which assist retailers that accept personal checks; Landlord Connections, which aids landlords appraising prospective tenants; and the National Consumer Telecom & Utilities Exchange, which serves telephone companies.[27]

B. Credit Reports and Credit Scores

Credit reports and credit scores are based on the assumption that past behavior is a relatively accurate predictor of future behavior. Although this assumption may be statistically well established, it conflicts with the notion that people should be given an opportunity to rebuild their reputation following past mishaps.

A typical credit report includes four main categories of information: identifying information, such as name, current and previous addresses, social security number, date of birth, and current and previous employers; payment history, including accounts at banks, retailers, and lenders; public records information, including bankruptcy filings, tax liens, judgments, and possibly

21. *See The Importance of the National Credit Reporting System to Consumers and the U.S. Economy: Hearing Before the Subcomm. on Fin. Insts. & Consumer Credit of the Comm. on Fin. Servs.*, 108th Cong. 2 (2008) (statement of Michael Staten, Director, Credit Research Center, Georgetown University) [hereinafter *Staten Testimony*], *available at* http://financialservices.house.gov/media/pdf/050803ms.pdf (discussing history of national credit-reporting system); *see also infra* Part II.D (outlining regulatory efforts for consumer protection).

22. Hunt, *supra* note 20, at 301.

23. *Id.*

24. *Id.* at 312.

25. *Id.* at 313.

26. *See* Hunt, *supra* note 20, at 313.

27. *See id.* at 314.

arrests or convictions; and inquiry information, which lists each inquiry into one's credit history.[28]

A credit score is a number based on a statistical formula that evaluates an individual's creditworthiness. The credit score is paramount, as most lenders rely on it exclusively, and ignore the credit report itself.[29] The most well-known score in the United States is the Fair Issac Co. (FICO), which is "considered the pioneer of the [behavior-scoring model] and accounts for a majority of all consumer credit scorecards used worldwide."[30] In 2006, the three major CRAs introduced VantageScore, a statistically based credit score ranging from 501 to 990 (the higher the number, the better the prediction of an individual's future financial behavior). The exact scoring calculations are trade secrets and are not disclosed, but the major reporting agencies explain which factors influence the score. Figure 1 illustrates the weighted variables used in VantageScore.

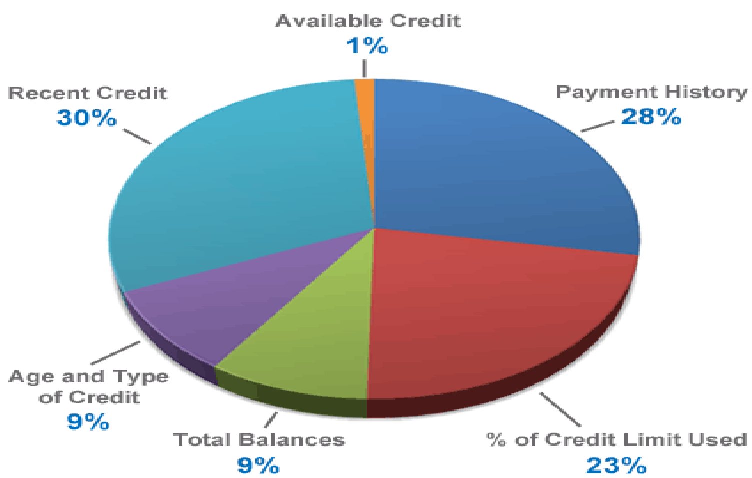

Figure 1—Credit Variables and Their Weighted Contribution to the Credit Score[31]

28. *See* Robert B. Avery et al., *An Overview of Consumer Data and Credit Reporting*, 2003 FED. RES. BULL. 47, 48, *available at* http://www.federalreserve.gov/pubs/bulletin/2003/0203lead.pdf (describing in detail information contained in credit reports).

29. A survey by the Consumer Bankers Association showed that "94% of banks cite credit scoring as the most frequently used method on automated loan processes." Kenneth G. Gunter, Notes & Comments, *Computerized Credit Scoring's Effect on the Lending Industry*, 4 N.C. BANKING INST. 443, 443 n.4 (2000) (quoting Cheryl Jenkins Richardson, *Credit Scoring of the Future*, COLLECTIONS & CREDIT RISK, Apr. 1999, at 19).

30. *Id.* at 445.

31. *See Achieve Your Financial Goals*, EXPERIAN, http://www.experian.com/consumer-products/vantage-score.html (last visited Nov. 19, 2013).

A credit report does not include one's credit score. Until recently, the credit score was not disclosed to consumers unless they were denied credit. Today, every consumer can buy his or her credit score from each of the three major CRAs.[32]

The Equal Credit Opportunity Act (ECOA) of 1974 encouraged the shift from judgmental methods, based on a credit officer's discretion, to a credit-scoring system that is supposed to be more objective and precise.[33] The ECOA was amended in 1976 to prohibit discrimination in the granting of credit on the basis of sex, marital status, race, color, religion, national origin, receipt of income from public assistance, and age.[34] Bostic and Calem have demonstrated that some of these restrictions can prevent the flow of potentially useful information for distinguishing between high- and low-quality applicants for homes, jobs, and credit.[35]

On the other hand, the credit-score system has been criticized as being "concerned solely with statistical predictability."[36] Specifically, the system often uses variables that have an arguably attenuated link to payment performance.[37] Moreover, it has been argued that these variables, which are supposedly objective, actually reflect racial bias; for example, occupations such as migratory work and low-paying service jobs are assigned low scores.[38] Following the financial crisis of 2008, the scoring system has further been criticized as contributing to the subprime mortgage problem due to its alleged failure to predict delinquencies.[39]

32. CRAs may charge a "fair and reasonable fee," as determined by the Consumer Financial Protection Bureau, for providing a credit score. *See* 15 U.S.C. § 1681g(f)(8) (2012); *see also infra* Part II.D.1 (discussing Fair Credit Reporting Act).

33. *See* Equal Credit Opportunity Act, Pub. L. No. 93-495, § 503, 88 Stat. 1500, 1521 (1974) (codified as amended at 15 U.S.C. 1691 (2012)).

34. Equal Credit Opportunity Act Amendments of 1976, Pub. L. No. 94-239, § 701(a)(1)-(2), 90 Stat. 251, 251 (1976) (codified as amended at 15 U.S.C. 1691(a)(1)-(2) (2012)).

35. *See* Raphael W. Bostic & Paul S. Calem, *Privacy Restrictions and the Use of Data at Credit Registries*, *in* CREDIT REPORTING SYSTEMS AND THE INTERNATIONAL ECONOMY, *supra* note 14, at 311, 325-28 (discussing impact of gender-information prohibition on credit-scoring efficacy).

36. Noel Capon, *Credit Scoring Systems: A Critical Analysis*, 46 J. MARKETING. 82, 85 (1982).

37. *See id*.

38. *See* Gunter, *supra* note 29, at 452; *see also* Peter L. McCorkell, *The Impact of Credit Scoring and Automated Underwriting on Credit Availability*, *in* THE IMPACT OF PUBLIC POLICY ON CONSUMER CREDIT 209, 215-17 (Thomas A. Durkin & Michael E. Staten eds., 2002) (discussing fairness to minority and low-income borrowers). *But see* ROBERT B. AVERY ET AL., DIV. OF RESEARCH & STATISTICS & MONETARY AFFAIRS, FED. RESERVE BD., DOES CREDIT SCORING PRODUCE A DISPARATE IMPACT? 1, 4 (2010), *available at* http://www.federalreserve.gov/pubs/feds/2010/201058/201058pap.pdf (finding negligible evidence of disparate impact by race, ethnicity, or gender, but limited disparate impact by age).

39. *See* Dean Foust & Aaron Pressman, *Credit Scores: Not-So-Magic Numbers*, BLOOMBERG BUS. WK. (Feb. 6, 2008), http://www.businessweek.com/magazine/content/08_07/b4071038384407.htm.

C. CRAs, Clients, and Consumers: Relationships and Incentives

While making their business out of gathering, compiling, and analyzing consumers' information, CRAs generally do not have privity of contract with those very same consumers. Their clients are usually those who furnish information about consumers—known as furnishers—and typically include lenders, insurers, employers, and landlords. In the past, CRAs refused to supply individual consumers with reports about themselves. Consequently, consumers were unable to dispute errors in their reports, and many were not even aware of the existence of any such errors.[40] Regulatory intervention, as described below, has changed this absurd result. In addition, the three national CRAs have recently begun to offer services for consumers, such as special credit reports, credit-report-monitoring products, identity-theft-prevention products, and fraud-resolution services. Although these services are fairly expensive, with some costing over $100 per year, a substantial portion of the U.S. population is willing to buy them. A 2003 survey sponsored by Privacy & American Business and reported by Harris Interactive found that 33.4 million Americans had purchased products to protect their privacy, such as identity-theft-prevention products and credit-report-monitoring products.[41]

Despite the expanding profits in monitoring services, most of the CRAs' revenues are derived from furnishers.[42] Consequently, CRAs consider furnishers as their "real" clients, while consumers are a less important source of revenue. This conception is reflected in CRAs' representation of their businesses. For example, on Experian's website, credit services are presented as the agency's first line of business, while consumer services are last on the list.[43] While all three national CRAs refer to furnishers as "clients" or "customers," consumers are merely referred to as "consumers."[44] This representation is not just a terminological issue; it reflects the CRAs'

40. *See* Staten & Cate, *supra* note 7, at 6-7 (discussing inaccuracies in credit reporting and denial of consumer access).

41. *See* HARRIS INTERACTIVE, IDENTITY THEFT: NEW SURVEY & TREND REPORT 31 (2003).

42. *See* Chi Chi Wu, *Automated Injustice: How a Mechanized Dispute System Frustrates Consumers Seeking To Fix Errors in Their Credit Reports*, 14 N.C. BANKING INST. 139, 180 (2010).

43. *See Experian Four Principal Business Lines*, EXPERIAN, http://www.experian.com/corporate/principal-businesses.html (last visited Nov. 19, 2013).

44. *See Who We Are*, TRANSUNION, http://www.transunion.com/corporate/aboutUs/whoWeAre.page (last visited Nov. 19, 2013) ("Our dedicated associates provide solutions to approximately 45,000 businesses and approximately 500 million consumers worldwide.") Equifax proffers that their "[c]ustomers have trusted Equifax for over 100 years to deliver innovative solutions with the highest integrity and reliability. . . . [They] empower *individual consumers* to manage their personal credit information, protect their identity, and maximize their financial well-being." Company Profile, EQUIFAX, http://www.equifax.com/about_equifax/profile/en_ca (last visited Nov. 19, 2013) (emphasis added). *Compare Business Services To Help You Succeed*, EXPERIAN, http://www.experian.com/business-services/business-services.html (last visited Nov. 19, 2013) (referring to "clients"), *with Interactive*, EXPERIAN, http://www.experian.com/corporate/experian-interactive.html (last visited Nov. 19, 2013) (referring to "consumers").

propensity to favor their clients' interests over consumers' needs and protection. Needless to say, those consumers who cannot afford the CRAs' services find themselves in an inferior position, as CRAs have little incentive to protect them. Numerous issues concerning consumers' rights to privacy and accurate credit reports demonstrate this lack of incentive.

1. Inaccuracies in Credit Reports

The accuracy of credit reports is the most prominent issue addressed by consumer advocates and in regulatory debates. Indeed, CRAs have an incentive to maintain accurate reports, as this is the commodity for which they are paid. High-quality reports will be rewarded by higher prices. Such incentive is limited, however, because accuracy is costly. At a certain point, it becomes more cost-effective for CRAs to correct the errors that consumers find rather than adopt a costly mechanism that would scrutinize every item in every file.[45]

Relying on consumer disputes is problematic for at least three reasons. First, many consumers are not aware of inaccuracies in their credit reports.[46] Second, consumers have no incentive to dispute errors that are favorable to them. Third, CRAs have no incentive to vigorously investigate consumers' disputes because such investigations do not usually produce revenues. In many cases, the costs of credit-report inaccuracies are higher for individuals than for CRAs, because CRAs consider their costs on an aggregate, rather than individual, level.[47] Moreover, true investigations are likely to drive creditors away as they can undermine the creditors' debt-collection efforts.[48]

It has also been demonstrated that lenders have incentives to report false information about their borrowers' credit discipline.[49] Through this opportunistic behavior, lenders obtain the benefits of data sharing without losing the competitive advantage provided by their access to exclusive information.[50] When a lender intentionally reports inaccurate information about a consumer's creditworthiness, the consumer is unable to shop around for better prices.[51] Consumer advocates have, therefore, argued that information-

45. *See* Staten & Cate, *supra* note 7, at 23 (explaining cost-effective means of ensuring accuracy).

46. *See infra* Part IV (discussing implications of consumers' irrationality in credit-reporting system).

47. *Cf.* Akos Rona-Tas, *Consumer Registries in the United States*, HUNGARIAN ACAD. OF SCI. 53 (2007), *available at* http://www.econ.core.hu/file/download/ktik13/KTIK13_registries_usa.pdf (noting lenders offset errors at aggregate level, called "asymmetry of aggregation").

48. *See* Wu, *supra* note 42, at 181–82 (highlighting rationales behind creditors' reluctance to investigate).

49. *See* Maria Semenova, *Information Sharing in Credit Markets: Incentives for Incorrect Information Reporting*, 50 COMP. ECON. STUD. 381, 385-410 (2008) (analyzing incentives for dishonest bank behavior).

50. *See id.* at 384-85.

51. *See* NAT'L ASS'N OF STATE PIRGS, MISTAKES DO HAPPEN: A LOOK AT ERRORS IN CONSUMER CREDIT REPORTS 6 (June 2004), *available at* http://georgiapirg.org/sites/pirg/files/reports/MistakesDoHappen 2004-1.pdf; *see also* Robert B. Avery et al., *Credit Report Accuracy and Access to Credit*, 2004 FED. RES. BULL. 297, 321, *available at* http://www.federalreserve.gov/pubs/bulletin/2004/summer04_credit.pdf

quality control should be a significant role of CRAs.[52]

Hunt distinguishes between two types of errors that concern lenders: "A type I error grants credit to a person based on erroneous information; a type II error denies credit to a person based on erroneous information."[53] The expected loss for *lenders* "associated with a type I error (the principal lost) is likely to be higher than the expected loss from a type II error (forgone profits on a loan)."[54] However, the cost to a consumer of being unable to acquire a loan is likely higher than the cost to the lender for being unable to provide the loan.[55] This clash of interests between lenders and consumers is reflected in consumers' credit reports. Because CRAs have an incentive to look after the interests of lenders—their "real" clients—credit reports may contain too many type II errors.[56]

Indeed, in light of the abovementioned incentives, all three national CRAs continue to fail in keeping accurate data.[57] However, the full impact of inaccuracies in credit reports is not clear. The probability of damage is higher if the error causes a consumer's credit score to be considerably higher or lower than the lender's benchmark; conversely, the probability is lower if the error causes a consumer's credit score to fall on or near the lender's benchmark. Many errors, such as a misspelled name, rarely cause monetary damage (although they cause much inconvenience).

The evidence pertaining to the impact of inaccuracies is inconsistent, as illustrated by the following studies. A 2002 study by the Consumer Federation of America and the National Credit Reporting Association revealed significant errors and inconsistencies in credit reports, some of which are likely to have artificially lowered some consumer credit scores and raised others.[58] The study also found that credit scores and the information in credit reports vary significantly among the three national CRAs.[59] The study concludes that "[m]any consumers are unharmed by these variations, and some probably

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(highlighting importance of supplying accurate information in timely manner).

52. *See* Semenova, *supra* note 49, at 382 (outlining argument for CRAs' role in preventing informational asymmetry).

53. Hunt, *supra* note 20, at 315.

54. *Id.*

55. *Id.*

56. *See id.*; *see also* FED. TRADE COMM'N, REPORT TO CONGRESS UNDER SECTIONS 318 AND 319 OF THE FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003, at 47 (2004), *available at* http://www.ftc.gov/reports/facta/041209factarpt.pdf (noting FCRA passed partly as response to lenders' preference for derogatory consumer credit information); Staten & Cate, *supra* note 7, at 7 (discussing accuracy in context of U.S. credit-reporting system's history).

57. *See generally* EDMUND MIERZWINSKI, NAT'L ASS'N OF ATTORNEYS GEN., CONSUMER PROTETION REPORT: NIGHTMARE ON CREDIT STREET (1994) (discussing gravity and frequency of credit bureau mistakes).

58. *See* CONSUMER FED'N OF AM. & NAT'L CREDIT REPORTING ASS'N, CREDIT SCORE ACCURACY AND IMPLICATIONS FOR CONSUMERS 24-25 (Dec. 2002), *available at* http://www.consumerfed.org/pdfs/121702CFA_NCRA_Credit_Score_Report_Final.pdf.

59. *See id.* at 22, 37.

benefit from them. . . . However, tens of millions of consumers are at risk of being penalized for incorrect information in their credit report, in the form of increased costs or decreased access to credit and vital services."[60] Specifically, the study estimates that "[a]lmost *one in ten consumers* runs the risk of being excluded from the credit marketplace altogether because of incomplete records, duplicate reports, and mixed files."[61]

One advocacy group claimed that inaccuracies in credit reports could cause at least eight million Americans to be miscategorized as subprime risks, resulting in tens of thousands of dollars in excess interest payments over the term of a thirty-year mortgage loan.[62] A study from the National Association of State PIRGs (Public Interest Research Groups) found errors in 25% of credit reports serious enough to cause a "denial of credit, such as false delinquencies or accounts that did not belong to the consumer."[63] The Federal Trade Commission (FTC) is currently undertaking an eleven-year comprehensive study of the accuracy of credit reports. In the pilot phase of the study, 53% of consumers found an error in their credit reports, and 10% of consumers found errors that would have likely had a material effect on their credit score.[64]

As a 2004 Federal Reserve study suggests, the effects of inaccuracies may be more significant in some cases than in others.[65] "In general, [consumers] with relatively low credit history scores or those with thin files are more likely to experience significant effects when a data problem arises."[66] In addition, the incidence of problems varies across groups: "older individuals, those with higher credit scores, and those living in higher-income and nonminority neighborhoods [show] the lowest incidence."[67]

2. Information Is Provided with No "Permitted Purpose" Under the Law

Thinking of their clients rather than the consumers, CRAs are often tempted to sell consumers' information, even if the law does not permit such a sale. One investigation of New York credit bureaus conducted in 1991 found that about a third of the agencies contacted were willing to provide credit reports without complying with the requirements of the Fair Credit Reporting Act

60. *Id.* at 37.

61. *See id.* at 39 (emphasis added).

62. *See* Fair and Accurate Credit Transactions Act of 2003, *Hearing on H.R. 2622 Before the U.S. House Comm. on Fin. Servs.*, 108th Cong. 4 (2003) (statement of Stephen Brobeck, Executive Director, Consumer Federation of America).

63. *See* NATIONAL ASS'N OF STATE PIRGS, *supra* note 51, at 11.

64. *See* L. DOUGLAS SMITH ET AL., PROCESSES FOR DETERMINING ACCURACY OF CREDIT BUREAU INFORMATION 14-15 (Sept. 2006), *available at* http://www.ftc.gov/reports/FACTACT/FACT_Act_Report_2006_Exhibits_1-12.pdf.

65. *See* Avery et al., *supra* note 51, at 321.

66. *Id.*

67. *See id*.

(FCRA).[68] Of course, this infringes upon consumers' right to privacy. As Edmund Mierzwinski said, "[n]o other industry than the credit bureaus intrudes so deeply or as often into our private affairs."[69]

3. *Identity Theft*

Identity theft occurs when one person uses another's personal identifying information, such as name, social security number, or credit card number, without permission.[70] According to the Bureau of Justice's data, "11.7 million people, . . . age 16 and older, were victims of identity theft between 2006 and 2008."[71] When a consumer's stolen identity is used to receive a loan and the loan is not paid back, it negatively affects the consumer's credit report.

Although committing such a crime is relatively easy in the absence of a universal, unique identification number, CRAs are also to blame for the prevalence of identity theft. It has been argued that the loose-matching-information procedures of CRAs contribute to identity-theft problems.[72] As mentioned previously, CRAs now offer identity-theft-prevention products, but they do not protect those consumers who are unwilling or unable to pay the high fees associated with such products. According to Evan Hendricks, editor and publisher of *Privacy Times*, some of the worst damages resulting from identity theft relate to consumers' frustrating interactions with the credit-reporting system.[73]

4. *Fertile Ground for Manipulation Through Marketing Lists*

Technological developments have enabled CRAs to collect and store billions of items concerning consumers' transactions, from mortgages to book purchases to casino gambling. Lenders, retailers, and other furnishers have come to appreciate the potential of such a database, and have even begun recruiting professionals from the fields of economics, psychology, and sociology in the hope of taking full advantage of this important resource.[74] CRAs have been eager to meet the demand. They analyze information

68. *See* MARK GREEN, CITY OF N.Y., DEP'T OF CONSUMER AFFAIRS, PRYING EYES: AN INVESTIGATION INTO PRIVACY ABUSES BY CREDIT REPORTING AGENCIES 10-11 (1991).

69. MIERZWINSKI, *supra* note 57, at 3.

70. *See Identity Theft*, FED. TRADE COMM'N, http://www.consumer.ftc.gov/features/feature-0014-identity-theft (last visited Nov. 19, 2013).

71. *Identity Theft and Data Security*, FED. TRADE COMMISSION, http://www.ftc.gov/opa/reporter/idtheft/ (last visited Nov. 19, 2013).

72. *See* Wu, *supra* note 42, at 149.

73. *See The Accuracy of Credit Report Information and the Fair Credit Reporting Act: Hearing Before the S. Banking Comm.*, 108th Cong. 8 (2003) (statement of Evan Hendricks, Editor/Publisher, Privacy Times) [hereinafter *Hendricks Testimony*], *available at* http://www.banking.senate.gov/03_07hrg/071003/hendriks.pdf.

74. *See* Alan Levinsohn, *Modern Miners Plumb for Gold*, 90 A.B.A. BANKING J. 52, 52 (1998) (describing information mining for database collection); *see also* Wu, *supra* note 42, at 180 (noting consumers cannot avoid having information included in CRA databases).

concerning consumers' personal lives in order to create marketing lists for their clients. Such use of personal information for marketing purposes, without obtaining the consumers' permission, infringes on consumers' privacy rights and creates fertile ground for manipulation and excessive borrowing. Indeed, "[t]he data on credit card choice and use show that consumer mistakes cost hundreds of dollars a year per consumer."[75]

D. Regulatory Efforts for Consumer Protection

1. The Fair Credit Reporting Act

The United States' experience with the credit-reporting system has produced significant economic benefits. These benefits include quick and convenient decision-making regarding financial services, broader consumer access to credit, encouraged entry of new lending competitors, increased consumer mobility, and reduced credit costs.[76] Despite these benefits, CRAs have a tarnished reputation as far as consumer protection is concerned. As demonstrated above, CRAs' incentives to favor their clients have created numerous consumer problems pertaining to privacy and accuracy of credit reports.

The first attempt to address these consumer problems without undermining the voluntary-credit-reporting system was made in 1970, when Congress passed the FCRA, "to insure that consumer reporting agencies exercise their grave responsibilities with fairness, impartiality, and a respect for the consumer's right to privacy."[77] The main provisions of the FCRA created a number of substantive requirements. CRAs were required to adopt reasonable procedures to ensure the confidentiality and accuracy of the information they maintain within their computer databases.[78]

CRAs could only release credit reports for permissible purposes; for example, to lenders making a loan decision, to employers considering a person for employment, to insurers underwriting a policy,[79] or in response to a court order.[80] The FCRA of 1970 required CRAs to provide consumers with a copy

75. Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 56 (2008).

76. *See Staten Testimony*, *supra* note 21, at 4-11; FRED H. CATE ET AL., FINANCIAL PRIVACY, CONSUMER PROSPERITY, AND THE PUBLIC GOOD 11-20 (2003) (discussing impact of robust national credit-reporting system); Barron & Staten, *supra* note 20, at 278-79.

77. Fair Credit Reporting Act, Pub. L. No. 91-508, § 602(a)(4), 84 Stat. 1114, 1128 (1970) (codified as amended at 15 U.S.C. § 1681(a)(4) (2012)).

78. *See id.* §§ 602(b), 607(b).

79. Insurers use credit reports to generate an insurance credit score, which tries to predict whether a potential insurant will have an insurance loss. *See* Diana Lee et al., *Give Us Some Credit: The Use of Credit Information in Insurance Underwriting and Rating*, 8 RISK MGMT. & INS. REV. 31, 33 (2005) (discussing use of credit information in insurance underwriting and rating).

80. *See* § 604, 84 Stat. at 1129. At their inception, these permissible purposes were very broad, but they were later narrowed.

of their reports and a list of recipients of those reports during the past six months, upon request, for a "reasonable charge."[81] It also required CRAs to implement a dispute-resolution process to investigate and correct errors.[82] This process required CRAs to investigate items that consumers reported as inaccurate within a reasonable period of time.[83] Additionally, the FCRA of 1970 required CRAs to promptly delete any disputed data that they could not verify within that period.[84] For unresolved disputes, the FCRA of 1970 allowed consumers to add a brief explanatory statement to their files.[85]

The FCRA of 1970 required furnishers, or other credit-report users, who denied credit, insurance, or employment based on credit-report information to inform the consumer of this fact, and supply the consumer with the name and address of the CRA that provided the report.[86] If the consumer contacted the CRA within 30 days after receiving this "adverse action" notice, the CRA had to provide the consumer with a free copy of his or her credit report.[87] The 1970 FCRA provided that derogatory information such as delinquencies and charge-offs could be kept in a consumer's file for a maximum of seven years, with the exception of personal bankruptcy records, which could stay on the file for up to fourteen years.[88] It also imposed civil liability through actions brought by the FTC, other federal regulators, and consumers.[89] However, provisions requiring only "reasonable procedures" and restricting defamation actions against CRAs unless the plaintiff could show "malice or willful intent to injure such consumer" sugared the pill for CRAs.[90]

2. *The 1996 FCRA Amendments*

Despite tremendous changes in technology and the market structure of the credit-reporting system, the FCRA was not significantly amended until 1996. The 1996 amendments constituted an effort to balance privacy concerns with new uses of credit reports, and to enhance consumer protection.[91] The

81. *See id.* §§ 609(a), 612.

82. *See id.* § 611.

83. *See* Fair Credit Reporting Act, Pub. L. No. 91-508, § 611(a), 84 Stat. 1114, 1132 (1970) (codified as amended at 15 U.S.C. § 1681i(a) (2012)).

84. *See id.*

85. *See id.* § 611(b).

86. *See id.* § 615(a).

87. § 612, 84 Stat. at 1132-33.

88. *See id.* § 605(a)(1), (4), (6).

89. *See* Fair Credit Reporting Act, Pub. L. No. 91-508, § 616, 84 Stat. 1114, 1134 (codified as amended at 15 U.S.C. § 1681n (2012)) ("[c]ivil liability for willful noncompliance"); *id.* § 617 ("[c]ivil liability for negligent noncompliance"); *id.* § 621 ("administrative enforcement").

90. *See id.* § 615(c) ("reasonable procedures to assure compliance"); *see also id.* § 610(e) ("[l]imitation of liability").

91. *See* Staten & Cate, *supra* note 7, at 13-17 (providing context and describing 1996 FCRA amendments); *see also* CATE ET AL., *supra* note 76, at 8 (describing how FCRA, as amended, has increased consumers' access to mortgage loans); Richard Downing Jr., *Changes to the Credit Reporting Act*, MORTG.

amendment made several substantive changes to the FCRA of 1970.

The 1996 amendments narrowed the "legitimate business need" requirement for furnishing consumer reports,[92] and provided that credit reports could be furnished for employment purposes only if the employer certified that the employee had consented in writing.[93] The 1996 amendments required CRAs to disclose "all information in the consumer's file," other than credit scores, to any consumer requesting access,[94] whereas the 1970 FCRA only required disclosure of the "nature," "substance," and "sources" of the information, and the "recipients" of the report.[95] The 1996 amendments also expanded the conditions under which consumers are entitled to receive a free credit report, and limited the fee in those situations in which the agencies are permitted to charge for credit reports.[96]

The 1996 amendments authorized CRAs to use information in reports for prescreening offers of credit and to share data across affiliated companies, provided that consumers may opt out of such information sharing.[97] The amendments prohibited the inclusion of medical information in a credit report furnished in connection with employment, credit, insurance, or direct marketing, without the consumer's consent.[98] Additionally, the amendments expanded consumers' rights to challenge the accuracy of their credit reports.[99] Finally, the 1996 amendments generally narrowed the time period for dispute investigations to thirty days, and required CRAs to conduct investigations at no cost to the consumer.[100]

3. *The Gramm-Leach-Bliley Act*

Congress passed the Gramm-Leach-Bliley Act (GLBA) in 1999, in response to a massive technological evolution, particularly the growing use of the Internet. The GLBA contains several provisions designed to protect consumers' financial information from improper use.[101] Under the GLBA, all

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BANKING, Apr. 1998, at 82, 83 (providing overview of 1996 amendments' significance to mortgage industry). *See generally* Consumer Credit Reporting Reform Act of 1996, Pub. L. No. 104-208, 110 Stat. 3009-425 (codified as amended at 15 U.S.C. §§ 1681-1681t (2012)).

92. *See* § 2403(a)(2), 110 Stat. at 3009-430.

93. *See id.* § 2403(b).

94. *See id.* § 2408(a).

95. Fair Credit Reporting Act, Pub. L. No. 91-508, § 609(a)(1), 84 Stat. 1114, 1131 (codified as amended at 15 U.S.C. § 1681g(3) (2012)).

96. *See* § 2410, 110 Stat. at 3009-442 to -443.

97. *See* Consumer Credit Reporting Reform Act of 1996, Pub. L. No. 104-208, §§ 2402(e), 2404(a), 110 Stat. 3009-425, -428, -441 to -442 (codified as amended at 15 U.S.C. §§ 1681a(d)(2)(A)(iii), 1681b(c), (e) (2012)).

98. *See id.* § 2405.

99. *See id.* § 2409(a).

100. *See id.*

101. *See* Gramm-Leach-Bliley Act, Pub. L. No. 106-102, §§ 501-10, 113 Stat. 1338, 1436-45 (1999) (codified as amended at 15 U.S.C. §§ 6801-09 (2012)).

financial institutions are required to disclose their privacy policies regarding the sharing of nonpublic personal information with third parties (such as CRAs).[102] In addition, consumers have the right to opt out of sharing nonpublic personal information with nonaffiliated third parties.[103]

4. The Fair and Accurate Credit Transactions Act

In 2003, the Fair and Accurate Credit Transactions Act (FACT Act) further amended the FCRA.[104] The FACT Act's stated purposes are, inter alia, "to prevent identity theft, improve resolution of consumer disputes, improve the accuracy of consumer records, [and] make improvements in the use of, and consumer access to, credit information."[105] The amendments are far ranging.[106] Consumers are now entitled to one free copy of their credit report each year from each of the three national CRAs.[107] Consumers are also entitled to receive their credit score more easily and at a limited cost.[108] The FACT Act instituted a system of fraud alerts to assist victims of identity theft in cleaning up their credit reports and to protect them from additional losses.[109] Consumers now have the option to dispute information in their reports directly with the furnisher of the information to the CRA.[110] Accounts arising from medical services are coded to conceal the nature of the medical treatment provided,[111] consumers' rights to opt out of marketing lists are enhanced,[112] and furnishers' liability is increased.[113]

In response to the growing use of risk-based pricing models, the definition of adverse action has been further expanded to include the granting of credit on less favorable terms.[114]

Although the United States' laws concerning CRAs have become more restrictive, they are still less stringent than those in Australia, Europe, and

102. *See id.* § 502(b)(1)(A).

103. *See id.* § 502(b)(1)(B). For an overview of the GLBA and its shortcomings, see generally Edward J. Janger & Paul M. Schwartz, *The Gramm-Leach-Bliley Act, Information Privacy, and the Limits of Default Rules*, 86 MINN. L. REV. 1219 (2002).

104. *See generally* Fair and Accurate Credit Transactions Act of 2003, Pub. L. No. 108-159, 117 Stat. 1952 (codified as amended at 15 U.S.C. §§ 1681-1681x (2012)).

105. *See* 115 Stat. at 1952.

106. For a review of the FACT Act, see generally Stephen F.J. Ornstein et al., *The Fair and Accurate Credit Transactions Act of 2003*, 11 J. STRUCTURED FIN. 27 (2005).

107. *See* 15 U.S.C. § 1681j(a)(1)(A) (2012). Seven states already allow at least one free copy annually: Colorado, Georgia, Maine, Maryland, Massachusetts, New Jersey, and Vermont. *See* NAT. ASS'N OF STATE PIRGS, *supra* note 51, at 4.

108. *See* 15 U.S.C. § 1681g.

109. *See id.* §§ 1681c-1, 1681c-2, 1681m, 1681g(d), 1681f.

110. *See id.* § 1681s-2(a).

111. *See id.* § 1681b(g).

112. *See* §§ 1681m(d)(1)(D), 1681s-3(a)(2).

113. *See* 15 U.S.C. § 1681s-2 (2012).

114. *See id.* § 1681m(h).

many other countries.[115] In Portugal, for example, CRAs must obtain a consumer's consent before they can sell or collect any credit information, and in Australia CRAs can only report negative information.[116]

III. A WEAK LINK IN THE CURRENT REGULATORY SYSTEM: CONSUMERS' COGNITIVE LIMITATIONS

Under the FCRA, consumers play a significant role in facilitating the production of more accurate credit reports. Specifically, the FCRA places the burden of verifying credit-report accuracy on consumers by providing the right to receive a free annual credit report and by establishing a dispute-resolution process. This legislative approach envisions rational, vigilant, and alert consumers, who regularly monitor their credit reports, dispute errors, and opt out of marketing lists.

Theoretically, such vision has solid economic grounds. Staten and Cate argue that the FCRA approach resembles the extension of a product warranty by designating the consumer as the "'quality-control' inspector."[117] Thus, the monitoring responsibility is imposed on the consumer, who knows his credit history and can determine accuracy at the lowest costs.[118] Moreover, a rational consumer can decide whether it is worthwhile to incur the costs associated with monitoring credit reports and disputing errors.

In this Part, I will challenge these economic arguments by applying the behavioral-economic approach—a relatively new model that aspires to explain "relevant features of human behavior that are absent in the standard economics framework."[119] I will also demonstrate that consumers' rationality in decision-making is in fact doubtful, as is the justification for imposing monitoring responsibilities on consumers.[120]

A. The Misconception of the Consumer as Homo Economicus

A fundamental principle of the standard neo-classical economic approach is that "all human behavior can be viewed as involving participants who maximize their utility from a stable set of preferences and accumulate an

115. ROWENA OLEGARIO, A CULTURE OF CREDIT: EMBEDDING TRUST AND TRANSPARENCY IN AMERICAN BUSINESS 205 (2006).

116. *See id.*; Margaret J. Miller, *Credit Reporting Systems Around the Globe: The State of the Art in Public Credit Registries and Private Credit Reporting Firms, in* CREDIT REPORTING SYSTEMS AND THE INTERNATIONAL ECONOMY, *supra* note 14, at 25, 25 (providing overview of CRAs worldwide).

117. *See* Staten & Cate, *supra* note 7, at 22.

118. *See id*.

119. Diamond & Vartiainen, *supra* note 9, at 1.

120. *See generally* Oren Bar-Gill, *The Behavioral Economics of Consumer Contracts*, 92 MINN. L. REV. 749 (2008) (analyzing consumer rationality); Joshua D. Wright, *Behavioral Law and Economics, Paternalism, and Consumer Contracts: An Empirical Perspective*, 2 N.Y.U. J. L. & LIBERTY 470 (2007) (discussing different perspectives on behavioral economics of consumer contracts).

optimal amount of information and other inputs in a variety of markets."[121] In other words, the standard economics theory assumes that people are fully rational and always make intelligent choices.[122]

Behavioral-economics theory challenges these assumptions by using other social sciences such as psychology and sociology, as well as biology and neuroscience. These disciplines explore the behavior of real people, as opposed to the theoretical *homo economicus*, and raise questions about human rationality in decision-making.[123] While neo-classical economists analyze human behavior in a social vacuum, behavioral economists emphasize the complexity of human beings, their emotions, and how their environment affects them.[124]

Research in this field has demonstrated that individual preferences are not what economists had predicted.[125] An experiment conducted by cognitive psychologists Daniel Kahneman and the late Amos Tversky provides a salient example showing that even with simple problems, people often violate the most fundamental principles of rational choice.[126] Kahneman and Tversky requested one group of people to imagine a situation in which they arrive at the theater and find out that they had lost their ticket to the performance worth ten dollars.[127] Another group of people was requested to imagine arriving at the theater to buy a ticket to a performance and discovering that they had lost a ten-dollar bill from their wallet.[128] The participants of both groups were asked whether they still planned to attend the show.[129] Despite both cases bearing the same economic effect, most people in the lost-ticket group reported that they would not attend the show, while an overwhelming majority (88%) of the lost-bill group said they would still attend.[130]

Another illustration of a behavior that diverges from the neo-classical model is loss aversion, or the endowment effect. These terms refer to the concept that "the disutility of giving up an object is greater [than] the utility associated with

121. GARY S. BECKER, THE ECONOMIC APPROACH TO HUMAN BEHAVIOR 14 (1976).

122. *See* Samuel Bowles & Herbert Gintis, *Walrasian Economics in Retrospect*, 115 Q.J. ECON. 1411, 1413 (2000) (noting argument against economic standard of individual as "selfish calculating machine").

123. *See* Colin F. Camerer & George Loewenstein, *Behavioral Economics: Past, Present, Future*, *in* ADVANCES IN BEHAVIORAL ECONOMICS 3 (Colin F. Camerer et al. eds., Princeton Univ. Press 2004) (providing overview on development of behavioral economics).

124. *See* J. L. BAXTER, BEHAVIOURAL FOUNDATIONS OF ECONOMICS 6 (1993).

125. *See* Camerer et al., *supra* note 10, at 1216.

126. *See generally* Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCI. 1124 (1974). For a description of the Tversky and Kahneman experiment, see also Robert H. Frank, *Departures from Rational Choice: With and Without Regret*, *in* THE LAW AND ECONOMICS OF IRRATIONAL BEHAVIOR 13, 14-15 (Francesco Parisi & Vernon L. Smith eds., 2005).

127. *See* Frank, *supra* note 126, at 14 (explaining Tversky & Kahneman experiment).

128. *See id.*

129. *See id.*

130. *See id.*

acquiring it."[131] In other words, people hate losses more than they enjoy gains.[132]

Behavioral-economics theory also describes ways in which people sometimes fail to act in their own best interests.[133] In the following sections of this Article, I will focus on three types of judgment errors that people tend to make. As discussed in Part IV, infra, these errors are also reflected in the credit-reporting industry.

B. Unawareness and Financial Illiteracy

As mentioned previously, the *homo economicus* is fully rational and, even in situations that involve uncertainty, he or she has well-informed beliefs about how uncertainty will resolve itself.[134] Moreover, when new information becomes available, the *homo economicus* updates his or her beliefs using Bayes' Law, which explains the ability to reassess probabilities in light of new information.[135]

However, evidence shows that the concept of *homo economicus* is merely an allegory, as most humans are not perfectly informed and fail to make predictions that are consistent with Bayes' Law.[136] People's unawareness of laws, certain costs, and other relevant information can be a barrier in their attempts to maximize welfare. In fact, people are unaware of their

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131. Daniel Kahneman et al., *Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias*, J. ECON. PERSP., Winter 1991, at 193, 194.

132. *See* Daniel Kahneman et al., *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1325, 1325-26 (1990). Consider the following experiment: Half of the students in a class at Cornell University were given Cornell coffee mugs. *Id.* at 1330. The experimenter asked all of the students to examine a mug, either their neighbors' or their own. *Id.* Then the mug owners were invited to sell their mugs and the other students were invited to buy their neighbors' mugs. *Id.* at 1331. The results showed that mug owners demanded roughly twice as much to give up their mugs as others were willing to pay to get one. *Id.* at 1332. This suggests that people do not assign specific values to objects; when they have to give an object up, they are hurt more than they are pleased if they acquire the very same object. *See id.* In another experiment:

> Half of the students in a class . . . were given pens, [while] the others were given a token redeemable for an unspecified gift. All [students] were then asked to rank the attractiveness of six gifts under consideration as prizes in subsequent experiments. Finally, all the [students] were then given a choice between a pen and two chocolate bars. As in previous experiments, there was a pronounced endowment effect. The pen was preferred by 56 percent of those endowed with it, but only 24 percent of the other subjects chose a pen. However, when making the attractiveness ratings, the subjects endowed with pens did not rate them as more attractive.

Kahneman et al., *supra* note 131, at 197. "This suggests that the main effect of endowment is not to enhance the appeal of the good one owns, only the pain of giving it up." *Id.*

133. *See* Camerer et al., *supra note* 10, at 1217.

134. *See id.* at 1214-15.

135. *See id.* at 1215; *see also* DOUGLAS G. BAIRD ET AL., GAME THEORY AND THE LAW 79-121 (1994) (discussing application of Bayes' Law).

136. *See generally* David M. Grether, *Bayes Rule as a Descriptive Model: The Representativeness Heuristic*, 95 Q.J. ECON. 537 (1980).

unawareness; studies have shown that people know less about the sources of their actions, judgments, and decision-making than they thought.[137]

Illiteracy (and specifically financial illiteracy, which is relevant to this Article) is another important contributor to suboptimal choices. Bernheim was one of the first researchers to emphasize that most individuals lack basic financial knowledge and numeracy.[138] Several surveys covering the U.S. population or specific subgroups have consistently documented very low levels of economic and financial literacy.[139] With regard to credit literacy, Lewis Mandell "shows that the knowledge of financial matters among high school students to make credit decisions is extremely low."[140] It has been argued that financial illiteracy has become more severe, because consumers now have more responsibility for their financial lives, but no tools to make the right financial decisions.[141]

C. The Status Quo Bias

Numerous behavioral-economics studies establish the status quo bias as a common judgment error. Research has shown that "[p]eople are much more likely to stick with existing policies, consumption bundles, legislators, and so on than normative theories would predict, even when the costs of switching are very low."[142]

William Samuelson and Richard Zeckhauser demonstrated this effect, and labeled it as the status quo bias.[143] In one experiment, some subjects were given a hypothetical choice task in a neutral version in which no status quo was defined.[144] The experimenter explained to the participants:

> You are a serious reader of the financial pages but until recently have had few

137. *See* Gavin Mandel, *Unaware of Our Unawareness*, 308 SCI. 1624, 1625 (2005); *see also* Eddie Dekel et al., *Standard State-Space Models Preclude Unawareness*, 66 ECONOMETRICA 159 (1998).

138. *See* B. Douglas Bernheim, *Do Households Appreciate Their Financial Vulnerabilities? An Analysis of Actions, Perceptions, and Public Policy*, *in* TAX POLICY AND ECONOMIC GROWTH, 1–30 (1995); B. Douglas Bernheim, *Financial Illiteracy, Education, and Retirement Saving*, *in* LIVING WITH DEFINED CONTRIBUTION PENSIONS 38 (Olivia S. Mitchell & Sylvester J. Schieber eds., 1998).

139. *See* Annamaria Lusardi, *Household Savings Behavior in the United States: The Role of Literacy, Information, and Financial Education Programs*, *in* POLICYMAKING INSIGHTS FROM BEHAVIORAL ECONOMICS 109, 123-27 (Christopher L. Foote et al. eds., 2009) (discussing lack of financial literacy); Campbell et al., *supra* note 11, at 9 (noting financial-illiteracy research).

140. Lewis Mandell, *Financial Literacy in the U.S. and Efforts Toward Credit Education*, *in* THE IMPACT OF PUBLIC POLICY ON CONSUMER CREDIT 149, 158 (Thomas A. Durkin & Michael E. Staten eds., 2002) (describing financial literacy study conducted on high school students).

141. *See* James Surowiecki, *Greater Fools*, NEW YORKER (July 5, 2010), http://www.newyorker.com/talk/financial/2010/07/05/100705ta_talk_surowiecki.

142. Camerer et al., *supra* note 10, at 1224.

143. William Samuelson & Richard Zeckhauser, *Status Quo Bias in Decision Making*, 1 J. RISK & UNCERTAINTY 7, 8 (1988).

144. *See id.* at 12 (describing neutral hypothetical choice test).

> funds to invest. That is when you inherited a large sum of money from your great uncle. You are considering different portfolios. Your choices are: a) Invest in moderate-risk [company] . . . b) Invest in high-risk [company] . . . c) Invest in treasury bills . . . [or] d) Invest in municipal bonds.[145]

Other subjects were given the same choice but with one small difference: One of the options was designated as the status quo.[146] In this case, after the same opening sentence, the passage continues: "That is when you inherited a portfolio of cash and securities from your great uncle. A significant portion of this portfolio is invested in [a] moderate-risk [c]ompany. . . . (The tax and broker commission consequences of any change are insignificant.)"[147] Many different scenarios were investigated, all using the same basic experimental design.[148] Aggregating across all the different questions, Samuelson and Zeckhauser estimated the probability that an option will be selected when it is the status quo, or competing as an alternative to the status quo, as a function of how often it is selected in the neutral setting.[149] Their results implied that an alternative becomes significantly more popular when it is designated as the status quo.[150] Moreover, the advantage of the status quo increases with the number of alternatives.[151]

Another illustration of this phenomenon comes from the studies of automatic enrollment in 401(k) employee-savings plans. Until recently, most 401(k) plans used an opt-in design. When employees first became eligible to participate in the 401(k) plan, they received some plan information and an enrollment form, and had to actively choose to join by completing this form. Under the recent alternative of automatic enrollment, employees receive the same information but are told that unless they opt out, they will be enrolled in the plan (with some default options for savings rates and asset allocation). By

145. *Id.*
146. *See id.* at 12-13.
147. Samuelson & Zeckhauser, *supra* note 143, at 12-13.
148. *See id.* at 12-14 (outlining scenarios investigated).
149. *See id.* at 14-19 (explaining results of experiment).
150. *See id.*
151. *See* Samuelson & Zeckhauser, *supra* note 143, at 14-19; *see also* Sendhil Mullainathan, *Psychology and Development Economics*, *in* BEHAVIORAL ECONOMICS AND ITS APPLICATIONS 85, 99 (Peter Diamond & Hannu Vartiainen eds., 2007) (discussing status quo and bias). Samuelson and Zeckhauser also conducted the following field study to demonstrate the status quo effect:

> In the 1980s, Harvard University added several plans to its existing choice of health plans. This provide[d] an interesting test of status quo bias: how many of the old faculty chose the new plans and how many of the newly joined faculty chose the old plan? They [found] a stark difference. Existing employees 'chose' the older plans at two to four times the rate of the new plans. In other words, incumbent employees make the easiest choice of all: to do nothing.

Mullainathan, *supra*, at 99.

standard reasoning, this default change should have little effect on enrollment rates. In practice, however, studies show that it has a significant effect: In companies that offer an employee match, most employees eventually do join the plan, but enrollment occurs much sooner under automatic enrollment. For example, Brigitte Madrian and Dennis Shea found that initial enrollments jumped from 49.4% to 85.9%,[152] and James J. Choi et al. found similar results for other companies.[153] Indeed, "[f]or any employee, a change from any status quo entails time and effort, and many people seem to prefer to avoid both of these, especially if they are prone to procrastination."[154]

These studies show that defaults can have a major effect on human behavior, and therefore can assist in designing new institutions. One example is "Save More Tomorrow™," a program created by Richard Thaler and Shlomo Benartzi that uses inertia to increase savings.[155] The basic idea of this program is to induce people to make one active choice but in such a way that, even if they remain passive after making that choice, they are still saving.[156] Participants are invited to commit themselves to a target saving level and agree to start deducting a small level from their paycheck the following year.[157] Each year thereafter, as they receive a raise in their income, their contribution increases until they hit their target saving level.[158]

The cleverness of the program is that it uses inertia to increase savings. Indeed, "[t]he results have been stunning. In one firm, for example, more than 75% of those offered the plan participated in it . . . . Of these, less than 20% opted out of the program. As a result, savings rates rose sharply. By the third pay increase . . . , individuals had more than tripled their saving rates."[159] In the years since the pilot program, many major firms and pension-fund providers have adopted the program.[160]

For obvious reasons, many lenders and retailers take advantage of consumers' status quo bias. Trial subscriptions to newspapers are a familiar example. Consumers are tempted to sign up for a free trial subscription for a limited period of time, after which they are required to pay. Although

152. *See* Brigitte C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q.J. ECON. 1149, 1160 (2001).

153. *See* James J. Choi et al., *Optimal Defaults,* AM. ECON. REV., May 2003, at 180, 183-84; *see also* James J. Choi et al., *Defined Contribution Pensions: Plan Rules, Participant Choices, and the Path of Least Resistance*, 16 TAX POL'Y & ECON. 67, 77 (2002); Richard H. Thaler & Cass R. Sunstein, *Libertarian Paternalism*, AM. ECON. REV., May 2003, at 175, 176-77.

154. *See* Thaler & Sunstein, *supra* note 153, at 177.

155. *See* Richard H. Thaler & Shlomo Benartzi, *Save More Tomorrow™: Using Behavioral Economics To Increase Employee Saving*, 112 J. POL. ECON. S164, S170-71 (2004).

156. *See id.*

157. *See id.*

158. *See id.*

159. *See* Mullainathan, *supra* note 151, at 96.

160. *See* Thaler & Sunstein, *supra* note 153, at 177-78.

consumers may terminate the subscription at any point, many consumers do not chose to do so and end up paying for newspapers they hardly ever read.

D. Self-Control Problems

We often observe people who fail to follow through on their plans. Many people choose to spend too much money rather than save some for a rainy day, eat too much candy rather than salad, and watch television instead of exercising.[161] Behavioral-economics theory emphasizes the concept of "bounded willpower" (sometimes called "present-biased preferences"), which has a long pedigree in economics.[162] This concept "refers to the fact that human beings often take actions that they know to be in conflict with their own long-term interests."[163] The failure to choose the best option stems from a lack of self-control, which is human nature, at least since Adam and Eve.[164]

In more recent research, Gul and Pesendorfer posit that people have "temptation preferences," wherein they experience disutility from not choosing the option that is most enjoyable.[165] Their theory implies that a person might be better off if the temptation option were not available. People are willing to incur much expense to eliminate the tempting option.[166] This result—people's willingness to pay in advance and incur inconvenience in order to avoid behaviors they would otherwise freely choose—is a puzzle within neo-classical economics.

Most people are aware of the existence of temptation and try to avoid it by engaging outside help. However, many people underestimate the effect of temptation when they are in a "cold state,"[167] and when they are later exposed to it they cannot resist it. The behavioral economist George Loewenstein calls this phenomenon the "hot-to-cold empathy gap."[168]

Consumers are susceptible to self-control problems. They often buy products that they do not really need and spend more than they can afford while

161. *See* THOMAS C. SCHELLING, CHOICE AND CONSEQUENCE 57 (1984) (discussing failed New Year's resolutions).

162. *See* Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1479 (1998) (discussing bounded willpower).

163. *See* Jolls et al., *supra* note 162, at 1479; David Laibson, *Golden Eggs and Hyperbolic Discounting*, 112 Q. J. ECON. 443, 443 (1997) (presenting argument for consumer constraint of future choices); R.H. Strotz, *Myopia and Inconsistency in Dynamic Utility Maximization*, 23 REV. ECON. STUD. 165, 165 (1955-1956) (explaining individual action not consistent with long-term benefit).

164. *See* Mullainathan, *supra* note 151, at 104 (discussing self-control).

165. *See generally* Faruk Gul & Wolfgang Pesendorfer, *Temptation and Self-Control*, 69 ECONOMETRICA 1403 (2001).

166. *See* Laibson, *supra* note 163, at 444; Strotz, *supra* note 163, at 165.

167. *See* George Loewenstein, *Hot-Cold Empathy Gaps and Medical Decision Making,* 24 HEALTH PSYCHOL. S49, S51 (2005).

168. *See id.* at 52; George Loewenstein, *Out of Control: Visceral Influences on Behavior*, 65 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 272, 281-82 (1996) (discussing impact of visceral factors on future behavior).

in a cold state. Governments can assist consumers in dealing with these problems by banning or limiting the use of certain products (such as heroin and alcohol), or imposing taxes to discourage consumption. A mandatory cooling-off period for door-to-door sales, of the sort imposed by the FTC in 1972,[169] is another illustration of an attempt to protect consumers from their self-control problems. In addition, "some states have attempted to help gamblers by creating a mechanism by which they can put themselves on a list of people who are banned from casinos."[170]

E. Overoptimism

Optimism bias is another judgment error, whereby "individuals believe that their own probability of facing a bad outcome is lower than it actually is."[171] For instance, "most people think that their chances of having an auto accident are significantly lower than the average person's chances of experiencing this event, although of course these beliefs cannot all be correct; if everyone were below 'average,' then the average would be lower."[172]

Indeed, people are unrealistically optimistic even when the chances of a bad outcome are high. Although it is well known that approximately 50% of marriages in the United States end in divorce, almost all couples believe that the chances of their own marriages ending in divorce are approximately zero—even those couples who have already been divorced.[173]

169. *See* 16 C.F.R. § 429.1(a) (2013).

170. RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS 47 (2008).

171. Christine Jolls, *Behavioral Law and Economics*, *in* BEHAVIORAL ECONOMICS AND ITS APPLICATIONS, *supra* note 151, at 115, 123.

172. *Id.* at 123 (citation omitted). *See generally* David M. DeJoy, *The Optimism Bias and Traffic Accident Risk Perception,* 21 ACCIDENT ANALYSIS & PREVENTION 333 (1989). As Jolls describes:

> [A]n interesting subtlety here is that if the question is whether one's probability of experiencing a bad event is below the average probability of experiencing that event (as distinguished from the average *person's* probability of experiencing that event), then it is possible for most people to be below average. To illustrate, suppose that for 80% of the population the probability of being involved in an auto accident is 10%, and for 20% it is 60%. Then the average probability of being involved in an auto accident is 20% ($0.1 \times 0.8 + 0.6 \times 0.2 = 0.2$). So for 80% of the population, the probability of being involved in an auto accident (10%) is below the average probability (20%). But the average person has a 10% chance of being involved in an auto accident, and it would be impossible for more than half of the population to have a probability below this. The natural interpretation of most studies of optimism bias would seem to be that they request a comparison with the average person's probability, rather than with the average probability; the average probability would often be quite difficult to compute and not within the grasp of most subjects. Moreover, at least one study has dealt explicitly with the issue raised here and has found significant evidence of optimism bias even using the average probability benchmark.

Jolls, *supra* note 171, at 123 n.5; *see* Neil D. Weinstein, *Unrealistic Optimism About Future Life Events*, 39 J. PERSONALITY & SOC. PSYCHOL. 806, 809-12 (1980) (setting forth research on unrealistic optimism).

173. Heather Mahar, *Why Are There So Few Prenuptial Agreements?*, HARVARD LAW SCH. 1, 9 (John M.

People also tend to overestimate the accuracy of their estimations or forecasts.[174] Such overconfidence can have significant implications for business decisions, as many initiatives and investments depend on ranges of estimates.[175] Overconfidence stems from two main factors: the illusion of knowledge, which relates to the incorrect assumption that more information means a better-informed decision, and the illusion of control, which relates to people's belief that they have influence over the outcome of uncontrollable events.[176] Another interesting and related bias is the "other guy" effect, whereby consumers indicate that they are better informed and likely to be more responsible than unknown "others."[177]

These biases can explain individual risk taking. One way to reduce overoptimism, as Thaler and Sunstein suggest, is to remind people of a bad event.[178] It has previously been shown that people assess the likelihood of risks based on available relevant examples. If they can easily think of such examples, they are far more likely to be concerned about the risk.[179] For example, the purchase of natural-disaster insurance is greatly affected by recent experiences.[180]

This Part has attempted to show that contrary to the *homo economicus* paradigm, real consumers often make psychological judgment errors. As economist Richard H. Thaler put it:

> [T]he orthodox economic model of consumer behavior is, in essence, a model of robot-like experts. As such, it does a poor job of predicting the behavior of the average consumer. This is not because the average consumer is dumb, but rather that he does not spend all of his time thinking about how to make decisions.[181]

Olin Ctr. for Law, Econ., & Bus., Discussion Paper Series No. 436, 2003), *available at* http://lsr.nellco.org/harvard_olin/436.

174. *See* John S. Hammond et al., *The Hidden Traps in Decision Making*, 76 HARV. BUS. REV. 3, 8 (1998).

175. *See id.*

176. *See* Angelo Capuano & Ian Ramsay, *What Causes Suboptimal Financial Behaviour? An Exploration of Financial Literacy, Social Influences and Behavioural Economics* 132 (Univ. of Melbourne Legal Studies, Research Paper No. 540, 2011), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1793502.

177. *See* Thomas A. Durkin, *Consumers and Credit Disclosures: Credit Cards and Credit Insurance*, 2002 FED. RES. BULL. 201, 206, *available at* http://www.federalreserve.gov/pubs/bulletin/2002/0402lead.pdf (discussing "other guy" effect); Thomas A. Durkin, *Credit Cards: Use and Consumer Attitudes, 1970-2000,* 2000 FED. RES. BULL. 623, 628-33, *available at* http://www.federalreserve.gov/pubs/bulletin/2000/0900lead.pdf (same).

178. *See* THALER & SUNSTEIN, *supra* note 170, at 33.

179. *See id*. at 25.

180. *See* Paul Slovic et al., *Decision Processes, Rationality and Adjustment to Natural Hazards*, *in* THE PERCEPTION OF RISK 1, 1-31 (Paul Slovic ed., 2000).

181. Richard H. Thaler, *Toward a Positive Theory of Consumer Choice*, *in* CHOICES, VALUES, AND FRAMES 269, 287 (Daniel Kahneman & Amos Tversky eds., 2000) (footnotes omitted).

It should be noted that no consumer is immune to such errors, not even "Nobel laureate economists, sophisticated investors, and MBA students."[182] For example, even the most sophisticated investors tend to be overconfident, relying on rules of thumb when deciding how to invest.[183] It has also become evident that emotional responses are dominant in the decision-making processes of professional traders.[184]

IV. THE IMPLICATIONS OF CONSUMERS' IRRATIONALITY IN THE CREDIT-REPORTING SYSTEM

A. Unawareness of Rights Under the FCRA

In 1979, the Credit Research Center at Purdue University conducted a survey of California bank cardholders to assess their understanding of the function of CRAs. Only 37% correctly identified CRAs as record-keeping agencies and the study concluded that consumers' knowledge of CRAs was quite limited.[185]

Since then, consumers' literacy has only slightly improved. In a national survey in 2005, the United States Government Accountability Office (GAO) found that consumers understood the basics of credit reporting and the dispute process, but not much more.[186] For example, many consumers did not know how long items remained on their credit reports or the impact their credit history could have on insurance rates and potential employment.[187]

In 2008, a survey commissioned by the Consumer Federation of America and Washington Mutual Bank found that consumers still have a poor

182. Lauren E. Willis, *Against Financial-Literacy Education*, 94 IOWA L. REV. 197, 226-27 (2008).

183. *See* THALER & SUNSTEIN, *supra* note 170, at 124-25 (providing examples of investors using rules of thumb). *See generally* Peter H. Huang, *Regulating Irrational Exuberance and Anxiety in Securities Markets*, *in* THE LAW AND ECONOMICS OF IRRATIONAL BEHAVIOR 501 (Francesco Parisi & Vernon L. Smith eds., 2005); Donald C. Langevoort, *Selling Hope, Selling Risk: Some Lessons for Law from Behavioral Economics About Stockbrokers and Sophisticated Customers*, 84 CALIF. L. REV. 627 (1996); Peter G. Gosselin, *Experts Are at a Loss on Investing*, L.A. TIMES, May 11, 2005, http://articles.latimes.com/2005/may/11/nation/na-nobel11; James J. Choi et al., *Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds* (Nat'l Bureau of Econ. Research, Working Paper No. 12261, 2006), *available at* http://www.nber.org/papers/w1226 1.pdf; Jason Zweig, *Five Investing Lessons from America's Top Pension Fund*, CNN MONEY (Jan. 1, 1998), http://money.cnn.com/magazines/moneymag/moneymag_archive/1998/01/01/236875/index.htm.

184. *See* Huang, *supra* note 183, at 510-11. Apparently, even the weather affects investment decisions. *See generally* David Hirshleifer & Tyler Shumway, *Good Day Sunshine: Stock Returns and the Weather*, 58 J. FIN. 1009 (2003).

185. *See* William C. Dunkelberg et al., *Consumer Perceptions of Credit Bureaus* 3-4 (Credit Research Ctr., Krannert Graduate Sch. of Mgmt., Purdue Univ., Workng Paper No. 26, 1979), *available at* http://faculty .msb.edu/prog/CRC/pdf/wp26.pdf.

186. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-223, CREDIT REPORTING LITERACY: CONSUMERS UNDERSTOOD THE BASICS BUT COULD BENEFIT FROM TARGETED EDUCATIONAL EFFORTS 10-11 (2005) [hereinafter GAO REPORT] (concluding consumers lacked knowledge of credit report contents, uses, and other impacts).

187. *See id*.

understanding of credit scores, although their knowledge has slightly improved over the years.[188] For instance, "[l]ess than one-third of Americans (31%) . . . understand that credit scores indicate risk of not repaying a loan, rather than factors like knowledge of, or attitude toward, consumer credit."[189] In addition, "[m]any Americans fail to understand that one's credit score reflects only how [he or she] use[s] credit, not factors such as income and age."[190]

The problem of financial illiteracy is enhanced by consumers' unawareness of basic rights associated with the credit-reporting system, as discussed in more detail below.

1. Unawareness of the Right To Receive a Free Credit Report

According to the GAO survey, less than half of consumers (47%) know that the new law entitles all consumers to request one free credit report per year.[191] The survey also showed that only "58 percent of consumers had seen their credit reports at some point in time and that 45 percent of this group had viewed them within the last year."[192] Of the 58 percent who said they had viewed their reports, "the largest percentage [48 percent] said that they had seen their reports because they were making a large purchase, such as a car or home, or were refinancing."[193]

Such data shows that most consumers do not fulfill the monitoring task that the law has entrusted to them. This should not come as a surprise in light of the fact that most consumers are not even aware of their right to receive a free credit report. Unawareness, however, is not the only cause for the lack of consumer inspection of credit reports; the status quo bias is an important contributor too. Thus, "[w]hile the majority of consumers (86 percent) [in the GAO survey] said that they *should* check their reports periodically, only 61 percent of this group reported actually having *seen* their credit reports."[194]

2. Unawareness of the Right To Dispute Errors for Free

The GAO survey found that consumers knew they had the right to dispute information on their credit reports, but only "about one-third of consumers correctly responded that CRAs would investigate disputed information for free."[195] In addition, the survey found that only a small percentage (18 percent)

188. *See* Press Release, Consumer Fed'n of Am. & Wash. Mutual Bank, *Consumer Understanding of Credit Scores Improves but Remains Poor* (July 10, 2008), http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/Credit_Score_PR_7-10-08.pdf.

189. *Id.*

190. *Id.*

191. GAO REPORT, *supra* note 186, at 16.

192. *Id.* at 20.

193. *Id.* at 21.

194. *Id.* at 28 (emphasis added).

195. GAO REPORT, *supra* note 186, at 28.

had actually disputed inaccuracies at some point.[196]

Unawareness and procrastination—results of the status quo bias—may explain these results, but another factor is the dispute process itself. It has been argued that the current dispute process does not involve real investigation.[197] Rather, it is an automatic procedure that discourages consumers from disputing errors.[198] In this process, the consumer's written dispute and any accompanying documents are reduced into a two- or three-digit code that the assigned agency employee believes best describes the dispute.[199] This code alone is sent to the furnisher by a computer message; the consumer's documents are not forwarded to the furnisher, and there is no human contact between the CRA and the furnisher.[200] The consumer's complaint is then investigated by the furnisher, only on the basis of the received code.[201] In fact, the furnisher simply confirms that the limited information in the CRA's computer message matches its records, and then verifies the disputed information to the CRA. Needless to say, CRAs blindly accept the furnisher's response, and do not conduct any further investigation on the consumer's behalf.[202]

As demonstrated above, financial illiteracy, unawareness, and procrastination play a significant role in consumers' failure to monitor their credit reports and improve their accuracy. The next section will show how these factors and other consumer biases are exploited by the credit-reporting system via marketing lists.

B. Exploiting Biases Through Marketing Lists

In recent years, the utilization of credit history from CRAs' files has been very popular. Used by various retailers, prescreened solicitations have become an important source of new accounts for credit-card issuers. More than six billion solicitations were mailed in 2005 alone.[203]

These solicitations, especially in the consumer-credit market, are considered a fertile ground for manipulation, as many firms seek to exploit consumers'

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196. *See id.*

197. *See* Wu, *supra* note 42, at 156-57 (arguing credit-reporting dispute system fundamentally flawed).

198. *See id.* at 157 (arguing automated, computer-driven system precludes investigation).

199. *See id.* at 157-58 (criticizing converting detailed written dispute into two or three digit code).

200. *See id.* at 158 (explaining code not sent with supporting documentation of account applications, billing statements, letters, and payoff statements).

201. *See* Wu, *supra* note 42, at 158 (arguing supporting documentation omitted in investigation could be overwhelming or even conclusive proof).

202. *See id.* at 156-58 (describing automated process involving furnishers and CRA); *see also Hendricks Testimony*, *supra* note 73, at 6-7 (arguing CRAs failing in investigation process).

203. *See* Thomas A. Durkin, *Credit Card Disclosures, Solicitations, and Privacy Notices: Survey Results of Consumer Knowledge and Behavior*, 2006 FED. RES. BULL. A109, A115, *available at* http://www.federal reserve.gov/pubs/bulletin/2006/06creditcards.pdf.

biases.[204] Indeed, marketing lists from CRAs enable creditors to generate information and estimations about potential borrowers that even the borrowers do not necessarily know about themselves. Such information not only includes consumers' credit scores, but also their likely performance regarding a particular set of loan products, and whether they qualify for a better, cheaper loan.[205] As Duncan MacDonald, former general counsel of Citigroup Europe and North America, put it so well:

> No other industry in the world knows consumers and their transaction behavior better than the bank card industry. It has turned the analysis of consumers into a science rivaling the studies of DNA . . . .
>
> The mathematics of virtually everything consumers do is stored, updated, categorized, churned, scored, tested, valued, and compared from every possible angle in hundreds of the most powerful computers and by among the most creative minds anywhere. In the past 10 years alone, the transactions of 200 million Americans have been reviewed in trillions of different ways to minimize bank card risks.[206]

Yet creditors are not required to reveal this information to the borrowers.[207] Nor are they required to offer the best and cheapest product that matches their borrowers' interests. This lack of information enhances consumers' biases, particularly overoptimism and self-control problems. Indeed, behavioral economists suggest that consumers underestimate how much they will borrow and overestimate their ability to pay bills in a timely manner.[208] As a result, many consumers are tempted by prescreened solicitations to pick a wrong product, a much more expensive product, or a product they do not really need.

In light of these problems, the legislature has allowed consumers to opt out of marketing lists. However, a 2004 survey found that only about 20% of consumers were aware of their right to opt out of marketing lists.[209] In

204. *See* MICHAEL S. BARR ET AL., NEW AM. FOUND., BEHAVIORALLY INFORMED FINANCIAL SERVICES REGULATION 4 (Oct. 2008), *available at* http://www.newamerica.net/files/naf_behavioral_v5.pdf.

205. *See id.* at 5.

206. Duncan A. MacDonald, *Viewpoint: Card Industry Questions Congress Needs To Ask*, AM. BANKER (Mar. 23, 2007), http://www.americanbanker.com/issues/172_58/-306775-1.html.

207. *See* Oren Bar-Gill & Oliver Board, *Product-Use Information and the Limits of Voluntary Disclosure*, 14 AM. L. & ECON. REV. 235, 263 (2012) (arguing "policy makers should consider mandating disclosure of product-use information").

208. *See* Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373, 1375-76 (2004).

209. *See* Durkin, *supra* note 203, at A117. Some results from this survey were included in a report to Congress as required by the FACT Act in 2004. *See also* BD. OF GOVERNORS OF THE FED. RES. SYS., REPORT TO THE CONGRESS ON FURTHER RESTRICTIONS ON UNSOLICITED WRITTEN OFFERS OF CREDIT AND INSURANCE (2004), *available at* http://www.federalreserve.gov/boarddocs/rptcongress/UnsolicitedCreditOffers2004.pdf. Since the Report's publication in 2004, it is possible that today, a higher proportion of consumers are aware of their right to opt out from marketing lists.

addition, only 20% of cardholders and 33% of noncardholders who were aware of such a right had placed their names on an opt-out list (meaning that approximately 4% to 6% of consumers had placed their names on an opt-out list).[210] This figure is similar to the "proportion of opt-outs indicated by a review of a large sample of [CRA] files at approximately the same time."[211] Interestingly, for consumers aware of their right to opt out, "a larger proportion of those with credit cards than those without (38 percent versus 14 percent) said that they had thought about placing their names on the opt-out list but had not yet done so."[212]

Here too, overoptimism and the "other guy" effect have a major influence on consumers. Consumers may feel that their own finances are more adequately controlled than those of "other" consumers and that opting out is therefore unnecessary.[213] Indeed, evidence of such effect was found in the 2004 survey. "When asked . . . whether they think that pre-approved offers of credit cards cause *other people*, in general, to use too much credit, about 85 percent [of respondents] said yes."[214] However, "[w]hen asked . . . whether pre-approved offers have led *them* to use too much credit, only 15 percent" of respondents said yes.[215]

As discussed in Part II.C, supra, these biases combined with CRAs' lack of incentives to protect consumers result in substantial economic harm to consumers. The next Part will explore possible solutions that may fit into the behavioral-economic model. Specifically, I will analyze two potential consumer-protection mechanisms: applying psychological tools for a better-designed system (libertarian paternalism) and enhancing consumer financial literacy. The behavioral-economic approach has yet to be applied to the credit-reporting system and will hopefully give new insights into problems that affect every consumer in the United States.

V. CONSUMER-PROTECTION MECHANISMS

A. Consumer Protection Under the Policy of Libertarian Paternalism

1. The Policy and Its Benefits

Numerous economists and legal analysts are libertarians. They believe that people should be given as many choices as possible, enabling them to choose the one that suits them best. As a result, they oppose government intervention and are skeptical about nudging measures that they consider coercive and

210. *See* Durkin, *supra* note 203, at A117.
211. *Id.* at A117 n.15.
212. *Id.* at A117 (emphasis added).
213. *See id.* at A117-18.
214. Durkin, *supra* note 203, at A118.
215. *Id.*

paternalistic.[216]

Thaler and Sunstein argue that this antipaternalistic view is based on "a false assumption and at least two misconceptions. The false assumption is that people always . . . make choices that are in their best interest."[217] As explained in Part III, supra, people sometimes fail to behave in their own best interests because of unawareness, incomplete information, self-control problems, or the status quo bias. The policy of libertarian liberalism, just as the vehicle of "debiasing through law" responds to individuals' judgment errors by operating directly on the errors and helping to reduce or eliminate them.[218]

"The first misconception is that there are viable alternatives to paternalism."[219] As Thaler and Sunstein explain, in many situations both private and public actors must make choices that impact other people.[220] Thaler and Sunstein demonstrate that even a simple action of organizing a menu, which consists of different healthy and unhealthy food, involves some sort of paternalism, because the order in which the food is arranged influences the choices people make.[221]

"The second misconception is that paternalism always involves coercion."[222] In the previous example, does the choice of food arrangement coerce people to eat certain food? Or, as Thaler and Sunstein put it, "[w]ould many object to putting the fruit before the desserts at an elementary school cafeteria if the outcome were to increase the consumption ratio of apples to Twinkies?"[223]

Those who do not object to nudging measures will probably support a policy that Thaler and Sunstein call "libertarian paternalism."[224] This policy is intended to influence the choices people make in a way that will promote their welfare.[225] However, because the policy does not block choices, it is considered a relatively weak and unobtrusive type of paternalism.[226] In the cafeteria example above, children are still able to choose Twinkies over apples; the framing of the menu is only trying to nudge them toward a better choice.

One of the main benefits of libertarian paternalism, at least in its least intrusive form, is that it "imposes trivial costs on those who seek to depart from

216. *See* THALER & SUNSTEIN, *supra* note 170, at 9.
217. Thaler & Sunstein *supra* note 153, at 175.
218. *See* Christine Jolls & Cass R. Sunstein, *Debiasing Through Law*, 35 J. LEGAL STUD. 199, 200 (2006).
219. Thaler & Sunstein, *supra* note 153, at 175.
220. *See id.*
221. *See id.*
222. *Id.*
223. Thaler & Sunstein, *supra* note 153, at 175.
224. *See id.*
225. *See id.*
226. *See* Sunstein & Thaler, *supra* note 12, at 1161; *see also* Samuel Issacharoff, *Disclosure, Agents, and Consumer Protection* 59-61 (N.Y. Univ. Law & Econ. Working Papers, Paper No. 228, 2010), *available at* http://lsr.nellco.org/cgi/viewcontent.cgi?article=1232&context=nyu_lewp (discussing "soft paternalism").

the planner's preferred option."[227] Colin Camerer et al. propose a similar policy, called "asymmetric paternalism," which is focused on the benefit of low costs.[228] They define a regulation as "asymmetrically paternalistic if it creates large benefits for those who make errors, while imposing little or no harm on those who are fully rational."[229]

2. "Nudging" the Credit-Reporting System

a. Disclosure and Framing

People often act irrationally and ignore their best interests because of unawareness, lack of information, and other biases. Disclosure and framing are the most recognizable tools of libertarian paternalism that nudge people to make more-informed and aware decisions.[230] These tools are appealing because they increase error correction of those consumers who are prone to cognitive biases, while maintaining maximum flexibility for those who behave rationally.[231]

Behavioral economists have found that reframing a document or situation in a subtle way can have a large effect on human behavior. For example, people are more likely to perform self-examinations for skin and breast cancer if they are told about the increased risk if they fail to do so, rather than the reduced risk if they do so.[232] Such changes in framing are irrelevant from the perspective of *homo economicus*, but are powerful with respect to real people.[233] Thus, like defaults, framing effects can play a dominant role in setting a consumer-protection policy.[234]

Disclosure is, however, the most common tool of behavioral economics used for improving consumer welfare. It has been argued that "[i]nformation remedies are most likely to be the most effective solution to information problems. They deal with the cause of the problem, rather than its symptoms, and leave the market maximum flexibility."[235] Indeed, disclosure advances and enhances consumers' knowledge about pricing and other features of products, thus reducing transaction costs.[236] Another advantage of disclosure is its

227. Sunstein & Thaler, *supra* note 12, at 1162.

228. Camerer et al., *supra* note 10, at 1212 (defining asymmetric paternalism).

229. *Id.* at 1212.

230. *See id*. at 1232.

231. *See* Issacharoff, *supra* note 226, at 60.

232. *See* THALER & SUNSTEIN, *supra* note 170, at 159.

233. *See* Amos Tversky & Daniel Kahneman, *Rational Choices and the Framing of Decisions, in* CHOICES, VALUES, AND FRAMES, *supra* note 181, at 209, 210 (arguing "the logic of choice does not provide an adequate foundation for . . . descriptive . . . decision making.").

234. *See* Camerer et al, *supra* note 10, at 1230.

235. Howard Beales et al., *Information Remedies for Consumer Protection*, 71 AM. ECON. REV. 410, 413 (1981).

236. *See* Durkin, *supra* note 203, at A109.

compatibility with existing market forces that urge sellers to make their products known, disclose favorable pricing, and expose other sellers' inadequacies.[237] In addition, disclosure is considered relatively low in costs, both concerning market disruption and out-of-pocket expenditures.[238] The main cost of disclosure is that of implementation.

Thus, not surprisingly, mandatory disclosure as a consumer-protection tool has become ubiquitous in the United States. To name just a few federal laws: the Securities Act of 1933,[239] the Securities Exchange Act of 1934,[240] the Investment Company Act of 1940,[241] and the Sarbanes-Oxley Act of 2002[242] were enacted to ensure that investors have access to information about the investments they buy or hold; the Truth in Lending Act (TILA)[243] mandates disclosure of key lending terms; and the Nutritional Labeling and Education Act (NLEA)[244] requires food producers to attach detailed nutrient-content labels to the food they produce.[245]

Disclosure has been proven to be particularly efficient when it is simple and easy to understand. For example, when Los Angeles County introduced hygiene-quality grade cards to be displayed in restaurants' windows, it not only increased consumers' sensitivity to changes in restaurants' hygiene quality, but also led restaurants to improve their hygiene.[246]

i. The Problem with Excessive Information

Although information disclosure may seem to be an appealing solution for uninformed consumers, it has its limitations. Critics have raised doubts about information disclosure's ability to substantially increase the number of informed consumers.[247] Specifically, questions have been raised about "how

237. *See* Thomas A. Durkin & Gregory Elliehausen, *Disclosure as a Consumer Protection*, *in* THE IMPACT OF PUBLIC POLICY ON CONSUMER CREDIT 109, 110 (Thomas A. Durkin & Michael E. Staten eds., 2002).

238. *See id.*

239. Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77aa (2012)).

240. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a-78pp (2012)).

241. Investment Company Act of 1940, Pub. L. No. 76-768, 54 Stat. 847 (codified as amended at 15 U.S.C. §§ 80a-1 to 80a-64 (2012)).

242. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

243. Truth in Lending Act, Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. §§ 1601-1667f (2012)). TILA has been referred to as "a crown jewel of the Disclosure Empire." *See* Omri Ben-Shahar & Carl. E. Schneider, *The Failure of Mandated Disclosure*, 159 U. PA. L. REV. 647, 665 (2011).

244. Nutritional Labeling and Education Act, Pub. L. No. 101-535, 104 Stat. 2353 (1990) (codified as amended at 21 U.S.C. § 301 (2012)).

245. For an overview of the literature of disclosure regulations and proposals, see generally Florencia Marotta-Wurgler, *Does Disclosure Matter?* (N.Y.U. Law & Econ., Research Paper No. 10-54, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1713860, and Ben-Shahar & Schneider, *supra* note 243.

246. *See* Ginger Zhe Jin & Phillip Leslie, *The Effect of Information on Product Quality: Evidence from Restaurant Hygiene Grade Cards*, 118 Q.J. ECON. 409, 449-50 (2003).

247. *See* Marotta-Wurgler, *supra* note 245, at 29-31 (discussing results of study on effect of increased

much information consumers can process and about the costs and benefits of providing information in specific settings."[248]

The main argument in this context is that the availability of excessive information may lead to "information overload,"[249] which discounts the potential cure for poor decision-making inherent in information disclosure.[250] Indeed, people who are overwhelmed with too much information often "lack the motivation to make a rational choice or simply choose a default."[251] Bombarding consumers with information may also lead to a secondary set of cognitive biases. For example, it has been argued that the NLEA, contrary to its stated purpose, may have contributed to the epidemic of eating disorders in the United States.[252] Thus, various academics suggest "that the starting point should probably be that 'less is better.'"[253]

Information is often written at a high level, making it more difficult to follow and understand. Financial privacy notices, for instance, "are written at a 3rd-4th year college reading level, instead of the junior high school level that is recommended for materials intended for the general public."[254]

Even available and easy-to-understand information does not always lead to communication and advanced knowledge.[255] Ben-Shahar and Schneider mention striking anecdotal evidence, which gives a strong indication that very few consumers read boilerplate language.[256] PCpitstop.com, a computer software maker, "put a clause in an end-user license agreement promising $1,000 to a user who responded. After four months and 3000 downloads," only one consumer responded.[257]

In another article, Ben-Shahar argues that providing greater opportunity to read contracts is useless, because consumers usually ignore the fine print.[258]

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contract accessibility and readership).

248. Camerer et al, *supra* note 10, at 1235.

249. *Id.*

250. *See* Issacharoff, *supra* note 226, at 62; *see also* Julie R. Agnew & Lisa R. Szykman, *Asset Allocation and Information Overload: The Influence of Information Display, Asset Choice, and Investor Experience*, 6 J. BEHAV. FIN. 57, 64-66 (2005) (discussing results of study regarding information overload in context of defined-contribution plans); Sheena S. Iyengar & Mark R. Lepper, *When Choice Is Demotivating: Can One Desire Too Much of a Good Thing?*, 79 J. PERSONALITY & SOC. PSYCHOL. 995, 996 (2000) ("[A]s both the number of options and the information about options increases, people tend to consider fewer choices and to process a smaller fraction of the overall information available regarding their choices.").

251. *See* Capuano & Ramsay, *supra* note 176, at 145.

252. *See* Camerer et al., *supra* note 10, at 1235.

253. *See* Geraint Howells, *The Potential and Limits of Consumer Empowerment by Information*, 32 J.L. & Soc'y 349, 363 (2005); *see also Professor Elizabeth Warren Speaks About the Consumer Financial Protection Agency*, YOUTUBE (July 17, 2009), http://youtu.be/lYd08e5Cjvs.

254. Mark Hochhauser, *Lost in the Fine Print: Readability of Financial Privacy Notices*, PRIVACY RTS. CLEARINGHOUSE (July 1, 2001), http://www.privacyrights.org/ar/GLB-Reading.htm.

255. *See* BARR ET AL., *supra* note 204, at 1.

256. *See* Ben-Shahar & Schneider, *supra* note 243, at 671-72.

257. *See id.*

258. *See* Omri Ben-Shahar, *The Myth of the "Opportunity to Read" in Contract Law*, 5 EUR. REV. CONT.

Indeed, even Chief Judge Frank Easterbrook admitted recently, with regard to one hundred pages of Real Estate Settlement Procedures Act (RESPA) disclosure documents pertaining to the purchase of his own house: "I didn't read one word. I have a life to live."[259] A few months earlier, Judge Richard Posner made the same point, saying: "I tried to extend my home equity line of credit. The bank gave me hundreds of pages. I didn't read them. I just signed them."[260]

In addition to lack of time and impatience, various biases, such as the status quo bias, overoptimism, and self-control problems, lead people to ignore disclosures. The following example illustrates the aforementioned "other guy" effect:

> Although many financial products in the United States come with disclosures about risks—e.g., 'past performance is no guarantee of future results,' or 'you could lose your home, and any money you have put into it, if you do not meet your obligations under the loan'—consumers routinely ignore warnings that are not obviously tailored to their own situation, assuming these warnings are for others.[261]

These biases, as well as overwhelming or difficult-to-understand information, may decrease the effectiveness of disclosure as a tool for consumer protection. However, this "does not argue against the principal of asymmetric paternalism" or libertarianism.[262] Rather, it highlights the importance of identifying and maintaining a suitable disclosure,[263] which is the purpose of the following section.

ii. Disclosure of Right To Opt out and Right To Dispute Errors

Mandated disclosure can potentially be a very effective tool in the credit-reporting industry. As opposed to complex financial agreements or insurance

L. 1 (2009).

259. David Lat, *Quote of the Day: Law-and-Econ Types Don't Like To Waste Time*, ABOVE THE L. (Nov. 22, 2010, 11:29 AM), http://abovethelaw.com/2010/11/quote-of-the-day-law-and-econ-types-dont-like-to-waste-time.

260. Josh Blackman, *Easterbrook, Like Posner, Does Not Read Financial Disclosure Documents*, JOSH BLACKMAN'S BLOG (Nov. 20, 2010), http://joshblackman.com/blog/2010/11/20/easterbrook-like-posner-does-not-read-financial-disclosure-documents.

261. Willis, *supra* note 182, at 236 (citations omitted).

262. Camerer et al., *supra* note 10, at 1235.

263. *See* Marianne Bertrand & Adair Morse, *Information Disclosure, Cognitive Biases and Payday Borrowing* 1 (The Milton Friedman Inst. for Research in Econ., Working Paper Series No. 2009-007, 2009), *available at* http://bfi.uchicago.edu/RePEc/bfi/wpaper/BFI_2009-007.pdf. Bertrand and Morse suggest that "consumer information regulations based on a deeper understanding of cognitive biases might be an effective policy tool when it comes to regulating payday borrowing, and possibly other financial and non-financial products." *Id.*

policies (which defeat even the most sophisticated lawyers[264]), the information pertaining to the credit-reporting system, or at least the major rights that consumers should be aware of, can be presented in a relatively simple form.

Indeed, the FCRA uses the technique of mandated disclosure. Under the FCRA, CRAs are required to include a written summary of rights with every credit report they provide to consumers.[265] This summary must include, a description of: the right to obtain a free copy of a consumer's credit report and the method by which the report can be obtained; other circumstances under which a consumer has a right to obtain a free credit report; the right to dispute information in a consumer's file; the right to obtain a credit score and the method by which it can be obtained; and a list of all federal agencies responsible of the enforcement of these rights and their contact details.[266]

Under the FCRA, the FTC is required to provide a model summary of rights to be used by CRAs.[267] This model was originally issued in 1997[268] and was revised in 2004[269] to reflect changes made to the FCRA by the FACT Act. Although intended to be brief and easy to understand, the 2004 model summary of rights features the type of fine print that consumers usually ignore. For example: The important (and relatively new) right to obtain a free credit report is hidden between the dense lines of the summary; consumers are not informed as to how to obtain a free report, but rather they are referred to the FTC's website; it is not clear that consumers have a right to dispute errors for *free*; and the description of the right to opt out of prescreened solicitations is unclear and does not attract the reader's eye.[270]

On August 27, 2010, the FTC proposed a newly revised model summary of rights, which is intended to improve the clarity, usefulness, and readability of the summary.[271] According to the FTC, "[t]he changes include reordering some of the information provided, as well as making formatting changes and minor wording changes to certain sections."[272]

The proposed changes improve the current summary of rights and make it much more reader-friendly. The major change is that the summary highlights four main consumer rights, at the beginning, in a format that draws the reader's

264. *See* Ben-Shahar & Schneider, *supra* note 243, at 43.

265. *See* 15 U.S.C. § 1681g (2012).

266. *See id.* § 1681g(c)(1)(B).

267. Under the Consumer Financial Protection Act of 2010, this authority was transferred to the Bureau of Consumer Financial Protection on July 21, 2011.

268. *See* Notices of Rights and Duties Under the Fair Credit Reporting Act, 62 Fed. Reg. 35,586, 35,591 (July 1, 1997) (to be codified at 16 C.F.R. pt. 601).

269. *See* Summaries of Rights and Notices of Duties Under the Fair Credit Reporting Act, 69 Fed. Reg. 69,776, 69,791 (Nov. 30, 2004) (to be codified at 16 C.F.R. pts. 601, 698).

270. *See* 16 C.F.R. pt. 698 app. F (2013).

271. *See* Summary of Rights and Notices of Duties Under the Fair Credit Reporting Act, 75 Fed. Reg. 52,655, 52,660-61 (proposed Aug. 27, 2010) (to be codified at 16 C.F.R. pt. 698).

272. *Id.* at 52,656.

attention:

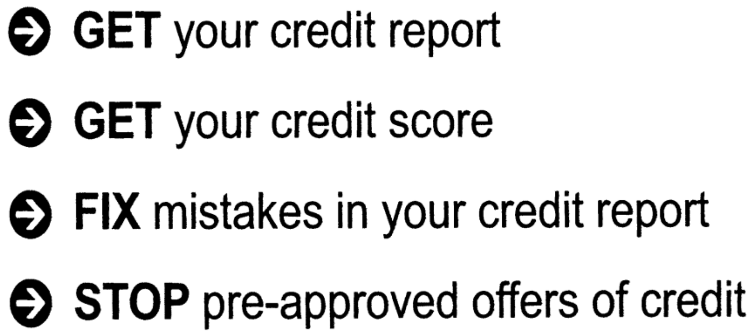

Figure 2—Format of emphasized consumer rights according to the proposed summary of rights[273]

The summary then explains each of these four consumer rights in greater detail. In addition, as opposed to the 2004 format, the proposed summary clearly describes how every consumer can obtain a free credit report.

However, it seems that the proposed summary of rights could be even more effective if additional changes were employed. First, the proposed summary still does not emphasize that consumers can obtain annual credit reports for *free*. Neither does it mention that consumers have a right to dispute information in their files for *free*. This is particularly salient information that should be emphasized, especially in light of consumers' widespread unawareness of these basic rights.

Second, the summary of rights is placed at the end of the credit report. It is doubtful that the average consumer would bother to read general information after having reviewed his or her entire credit report (a task that can be exhausting). The summary of rights would better meet its purpose if placed at the beginning of the credit report, or at least if the four main consumer rights were prominently displayed on the first page of the report (perhaps in bold or red print).

Third, while this summary provides consumers with important information when they obtain their own credit reports, many consumers do not request reports themselves.[274] "Nearly half of the 58 percent of consumers in [the GAO] survey who obtained their reports said that someone else had done the ordering for them. As a result, these consumers may not have received a copy of the summary of rights and may not have had the information necessary" to

273. *Id.* at 52,660.
274. *See* GAO REPORT *supra* note 186, at 30.

obtain a free credit report, initiate a dispute, or opt out of prescreened solicitations.[275]

It should be mentioned that consumers are informed of the right to opt out of prescreened solicitations through the solicitations themselves.[276] However, according to a survey conducted in 2004, less than one-tenth of cardholders indicated that they knew about the right to opt out of solicitations.[277] Thus, the summary of rights could play an important role in this context as well.

The problem of low-ordering percentage of credit reports, leading to fewer consumers informed of their rights, can be solved by increasing accessibility to credit reports, as discussed in the following section.

iii. Unlimited Access to Credit Reports and Credit Scores

As mentioned previously, in the past, consumers did not have access to their own credit reports. This absurd situation has changed; consumers now have access to their files and, since 2004, they are entitled to one free annual credit report from each of the three national CRAs. In cooperation with the FTC, the three national CRAs set up the website www.AnnualCreditReport.com to provide free access to annual reports. Consumers can also request a free credit report by mail or by calling a toll-free telephone number.[278]

Unfortunately, some CRAs have taken advantage of this amendment as a marketing tool. Consequently, there has been a proliferation of confusing advertising using "free credit report" in connection with the purchase of certain products and services.[279] In addition, when a consumer uses an Internet search engine to locate the official site for free credit reports, the search engine usually lists sponsored links to other websites, which share a similar look but charge for credit reports (for example, FreeCreditReport.com is owned by an Experian affiliate). FreeCreditReport.com also exploits consumers' credit naiveté and status quo bias by luring them with a free trial membership for thirty days, and then automatically charging them a monthly fee after the trial period is over.[280] Many consumers do not realize what they sign up for and are not aware of the fees because they do not inspect their credit card statements.

The FTC has received many consumer complaints, demonstrating the confusion and frustration surrounding the process of obtaining a free annual

275. *Id.*

276. *See* 15 U.S.C. § 1681m(d) (2012).

277. *See* Durkin, *supra* note 203, at A117.

278. *See All About Credit Reports*, ANNUALCREDITREPORT.COM, https://www.annualcreditreport.com/yourRights.action (explaining federal requirements and process for requesting reports) (last visited Nov. 19, 2013).

279. *See* Free Annual File Disclosures, 75 Fed. Reg. 9725, 9728 (Mar. 3, 2010) (to be codified at 16 C.F.R. pt. 610).

280. *See* FREECREDITREPORT.COM, http://www.freecreditreport.com (last visited Nov. 19, 2013) (offering free two-day credit report, or instant credit report and score for one dollar with trial membership).

report.[281] As a result, the FTC has recently amended the Free Annual File Disclosures Rule to require certain advertisements for "free" credit reports to include prominent disclosures designed to prevent consumers from confusing "free" offers with the federally mandated free annual file disclosures.[282] The FTC also gives important information, as well as animated videos, on its website.[283]

Despite these shortcomings, giving consumers a right to obtain a free annual credit report was a positive step in the path toward more accurate credit reports. One nationally representative survey found that after the passing of the FACT Act, "credit report request rates increase[d] from 27% to 44%. [Sixteen percent] of this increase is attributed solely to [the FACT Act]."[284] However, the rates of credit report requests, as well as the rates of consumers who have seen their credit reports, are still low.[285]

There are numerous advantages to giving consumers free access to their credit reports, especially in the contemporary computer age. First, regular inspection of credit reports would help to minimize inaccuracies. Evan Hendricks noted that "[t]he best way to ensure accuracy is for consumers to be 'plugged into' their own credit reports . . . ."[286] As explained above, more accurate reports are beneficial to CRAs as well as consumers, because they allow CRAs to offer a better product to their clients. Indeed, an international survey found that thirty-one out of sixty private CRAs around the world offered free credit reports to consumers as a means of correcting errors.[287] Moreover, since all of the data is already computerized, unlimited access would impose a minimal burden on CRAs. Creditors also benefit from more accurate and complete credit reports because of the potential for a more efficient credit-granting process.[288]

The second advantage is that unlimited access to credit reports can mitigate the harm caused by identity theft, because consumers can immediately see inquiries from improper sources.[289]

Third, the electronic channel offers a cheaper, faster, and more convenient way to resolve disputes.[290] In addition, it accommodates the regulatory goal of

281. *See* Free Annual File Disclosures, 75 Fed. Reg. at 9728.

282. *Id.* at 9731.

283. *See Free Credit Reports*, FED. TRADE COMMISSION, http://www.consumer.ftc.gov/articles/0155-free-credit-reports (last visited Nov. 19, 2013); *Video and Media*, FED. TRADE COMMISSION, http://www.consumer.ftc.gov/media (last visited Nov. 19, 2013).

284. Bin Zhang, *US Consumers' Response to FACTA*, H. JOHN HEINZ III SCH. OF PUB. POL'Y & MGMT. CARNEGIE MELLON U. 13 (2008), http://www.heinz.cmu.edu/research/235full.pdf.

285. *See supra* Part IV.

286. *Hendricks Testimony*, *supra* note 73, at 3.

287. *See* Miller, *supra* note 116, at 50.

288. *See* Avery et al., *supra* note 51, at 320-21.

289. *See Hendricks Testimony*, *supra* note 73, at 3.

290. *See id.*

notifying consumers, at a low cost, when negative information is placed on their credit reports.[291]

Ultimately, free access to credit reports is beneficial to consumers, CRAs, furnishers, and the entire economy. Some CRAs offer consumers unlimited access to their credit reports, but these services are expensive, costing approximately $200 per year.[292]

b. Defaults

Similar to disclosure, setting a default is another example of "changing the rules of the game."[293] As discussed in Part III, supra, the status quo bias significantly affects individuals facing default options. Additionally, individuals' assumptions that the default option is recommended by the entity that developed that option can affect their decision-making process. Many empirical findings demonstrate how variations in the framing of options lead to systematically different preferences.[294] Default rules should, therefore, be chosen carefully, as they can determine what outcome a consumer chooses, and they can dramatically impact consumer protection.[295]

Since the 1996 amendments to the FCRA, which, inter alia, granted every consumer the right to opt out of CRAs' marketing lists,[296] there has been widespread debate over this default rule. Consumer advocates have proposed shifting the opt-out rule to an opt-in regime, which would require CRAs to obtain explicit consent from consumers before using their names and addresses for marketing lists. This is the existing privacy regime in the European Union.[297]

291. *See id*.

292. *See Equifax Complete™ Advantage Plan*, EQUIFAX, http://www.equifax.com/credit-advantage (last visited Nov. 19, 2013) (offering unlimited access to credit report and score for $17.95 per month).

293. *See* BARR ET AL., *supra* note 204, at 4.

294. *See* Amos Tversky & Daniel Kahneman, *Advances in Prospect Theory: Cumulative Representation of Uncertainty*, *in* CHOICES, VALUES, AND FRAMES, *supra* note 181, at 44, 44-45; *see also* Eric J. Johnson et al., *Defaults, Framing and Privacy: Why Opting In-Opting Out,* 13 MKTG. LETTERS 5, 10-12 (2002) [hereinafter Johnson et al., *Defaults*] (discussing results of study on relationship between frames and defaults); Eric J. Johnson et al., *Framing, Probability Distortions, and Insurance Decisions*, 7 J. RISK & UNCERTAINTY 35, 48-49 (1993) (concluding framing led to inconsistent choices); Camerer et al., *supra* note 10, at 1226-27 (noting how defaults affect insurance choices).

295. *See* Johnson et al., *Defaults*, *supra* note 294, at 13-14. *But see* Michael E. Staten & Fred H. Cate, *The Impact of Opt-In Privacy Rules on Retail Credit Markets: A Case Study of MBNA*, 52 DUKE L.J. 745, 765 (2003). Staten and Cate argue that "both opt-in and opt-out [rules] give consumers the final say about whether their personal information is used. Neither approach gives individuals greater or lesser rights than the other." *Id*.

296. *See* Consumer Credit Reporting Reform Act of 1996, Pub. L. No. 104-208, § 2404(a)(2), 110 Stat. 3009-426, 3009-431 (codified as amended at 15 U.S.C. § 1681b(c) (2012)).

297. *See* Klein, *supra* note 2, at 339; *see also* Federico Ferretti, *A European Perspective on Consumer Loans and the Role of Credit Registries: The Need To Reconcile Data Protection, Risk Management, Efficiency, Over-Indebtedness, and a Better Prudential Supervision of the Financial System*, 33 J. CONSUMER POL'Y 1 (2010) (discussing data protection in European consumer credit markets).

Those who advocate shifting the default rule are mainly concerned with consumers' privacy. As mentioned previously, CRAs collect billions of items of information on almost every consumer in the United States. Some of this information may be embarrassing, and some of it may lead to harmful financial results. The opt-out rule infringes on consumers' privacy rights by taking away their control over the use of private information. Indeed, the "leading paradigm of information privacy conceives of it as a right to control the use of one's data."[298] It is based on the "liberal autonomy principle that seeks to place the individual at the center of decision-making about personal information use."[299] In this context, Edward Janger and Paul Schwartz argue that "information privacy should be conceptualized as a value constitutive of a democratic society."[300] Indeed, most nations recognize an individual's right to privacy.

An opt-in regime shifts the burden to the CRAs to convince consumers to permit disclosure.[301] It creates an entitlement of privacy which, from an information-forcing perspective, appears to be an improvement over an opt-out rule.[302]

However, privacy is not the only consideration when dealing with the opt-out rule. Marketing lists can be beneficial for many consumers because targeted solicitations give consumers potentially worthwhile information about new products, features, and pricing; they can reduce wasteful marketing to consumers that are unlikely to be interested, and they may even reduce the cost of subsidizing high-risk borrowers. In addition, some argue that the prescreening services of CRAs enhance competition in the credit card industry, allowing benefits such as lower interest rates, no annual fees, and rebates.[303]

Proponents of an opt-out rule also argue that an opt-in regime will impose new costs on companies and, ultimately, on consumers. Staten and Cate sought to calculate the cost of opt-in restrictions on the operations of MBNA Corporation, a financial institution that relies heavily on targeted marketing to attract consumers.[304] They found that restrictions on information sharing would reduce MBNA's targeted marketing materials' efficacy by

298. Janger & Schwartz, *supra* note 103, at 1247; *see also* U.S. Dep't of Justice v. Reporters Comm. for Freedom of Press, 489 U.S. 749, 763 (1989) ("[B]oth the common law and the literal understandings of privacy encompass the individual's control of information concerning his or her person."); Charles Fried, *Privacy*, 77 YALE L.J. 475, 482 (1968) ("Privacy is not simply an absence of information about us in the minds of others; rather it is the *control* we have over information about ourselves."); Richard A. Posner, *Privacy*, *in* 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 103, 104 (Peter Newman ed., 1998) ("[E]conomic analysis of the law of privacy . . . should focus on those aspects of privacy law that are concerned with the control by individuals of the dissemination of information about themselves.").

299. Janger & Schwartz, *supra* note 103, at 1247.

300. *Id.* at 1250-51.

301. *See id*. at 1243-44.

302. *See id.* (arguing in favor of opt-in regime).

303. *See* Klein, *supra* note 2, at 340.

304. *See* Staten & Cate, *supra* note 295, at 750.

approximately 27%, with an 18% lower response rate and a 22% increase in direct mail costs per account booked.[305] Moreover, there would be an additional 8% reduction in the company's net income, resulting from less qualified people receiving and acting on credit card solicitations.[306]

Those in favor of the current opt-out regime also stress the importance of access to information. Access contributes to transparency and competition, implicating the First Amendment rights of freedom of speech and freedom of the press.[307]

It has also been argued that because the status quo bias plays an important role in this context, many consumers who would perhaps have wanted to opt in will not do so.[308] Some have even argued that "conditioning the use of information on opt-in consent is tantamount to banning the use outright,"[309] because it is difficult for CRAs to obtain consumers' consent.

I do not find this last argument persuasive. First, it is much easier today for CRAs to communicate with consumers because many consumers use CRAs' services and products. In addition, CRAs will most likely succeed in obtaining consent because they provide services that most consumers need or desire.[310] For example, in 2009 the Federal Reserve promulgated Regulation E, which, prohibited banks from charging overdraft fees on most debit card transactions without the explicit opt-in of consumers. Banks responded aggressively with hard-hitting marketing campaigns to obtain consumers' consent. As a report from the Center for Responsible Lending Organization outlines: "One consultant even suggests offering a gift or cash offer to customers with four or more overdrafts annually who opt in, noting that this and other strategies will result in '[s]natching bank revenues from the jaws of Regulation E.'"[311] Although the results of efforts to obtain consumers' consent to fees are still being debated, banks still retain significant power over their clients.[312]

305. *See id.* at 775.

306. *See id.* at 776.

307. *See* Rafael del Villar et al., *Regulation of Personal Data Protection and of Credit Reporting Firms: A Comparison of Selected Countries of Latin America, the United States, and the European Union*, *in* CREDIT REPORTING SYSTEMS AND THE INTERNATIONAL ECONOMY, *supra* note 14, at 397, 397-98; *see also* Klein, *supra* note 2, at 340. *See generally* U.S. CONST. amend. I.

308. *See* Janger & Schwartz, *supra* note 103, at 1244; Staten & Cate, *supra* note 295, at 766.

309. CATE ET AL., *supra* note 76, at 24. *See generally* Michael E. Staten & Fred H. Cate, *The Impact of National Credit Reporting Under the Fair Credit Reporting Act: The Risk of New Restrictions and State Regulation*, FED. TRADE COMMISSION, http://www.ftc.gov/bcp/workshops/infoflows/statements/cate02.pdf (last visited Nov. 19, 2013) (arguing benefits of national credit-reporting system).

310. *See* Janger & Schwartz, *supra* note 103, at 1244.

311. CTR. FOR RESPONSIBLE LENDING, BANKS TARGET, MISLEAD CONSUMERS AS OVERDRAFT DEADLINE NEARS 3 (Aug. 5, 2010), *available at* http://www.responsiblelending.org/overdraft-loans/research-analysis/Banks-Target-And-Mislead-Consumers-As-Overdraft-Dateline-Nears.pdf; *see* Shahar Ziv & Matthew Walsh, Consumer Finance Paper 14 (Apr. 18, 2011) (unpublished paper) (on file with author) (discussing Regulation E).

312. *See* Ziv & Walsh, *supra* note 311, at 14.

The assumption that CRAs can easily obtain consumers' consent is troubling, because it suggests that consumers' right to privacy might turn into a "right that is regularly signed away."[313] It also makes one think whether, from the consumer's perspective, there is any difference between the current opt-out rule and the opt-in rule. I tend to believe that such a difference exists, as an opt-in regime gives the average consumer bargaining power, and consumers who are not in privity of contract with CRAs even greater leverage.

Second, the above reasoning, which relates the status quo bias to an opt-in rule, is also relevant to an opt-out rule. Many people who in fact want to opt out do not do so because of behavioral biases; this may lead to serious and far-reaching results.

Future research should examine the harm caused by the current regime and the costs associated with an opt-in rule. In addition, policy makers should reflect thoughtfully on the proper way to balance the clashing rights of consumers, CRAs, and other firms in this context.

B. Consumer Financial Education

1. Why Is Education in the Credit-Reporting System Appealing?

"Financial education can be compared to a road map to the American Dream. I believe that we need to teach all Americans the necessary tools to read that map, so that they can reach the Dream."[314]

Financial illiteracy is an important contributor to suboptimal choices. The financial-literacy education model aspires to give consumers tools and teach them how to "make welfare-enhancing choices in the insurance, credit, and investment marketplace."[315] Lauren E. Willis described the attractiveness of this model:

> Financial-literacy education is that rare public policy that entices across the political spectrum. Liberals envision an empowered consumer, confidently navigating the marketplace. Conservatives divine a responsible consumer, who understands her decisions and therefore can be held accountable for them. Free-marketers see flourishing innovation and abundant choices.[316]

"Financial education efforts vary by the setting, audience, and subject

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313. Mark A. Lemley, *Private Property*, 52 STAN. L. REV. 1545, 1551 (2000).

314. *The State of Financial Literacy and Education in America: Hearing Before the S. Comm. on Banking, Hous., & Urban Affairs*, 107th Cong. 50 (2002) (statement of Paul H. O'Neill, Secretary, U.S. Department of the Treasury).

315. Willis, *supra* note 182, at 284.

316. *Id.* at 201.

matter."[317] Jonathan Fox et al. organize these efforts into three categories. "First, there are programs directed at improving financial literacy by broadly addressing personal finance topics, such as budgeting, saving, and credit management. . . . In [this] category, there are several wide-ranging financial education initiatives aimed at school-age students," and other initiatives and national campaigns aimed at broader audiences.[318] "Second, there are programs that give specific training in retirement and savings and are generally offered by employers."[319] Third, there are programs that address "home buying and home ownership," which have the longest history among financial education initiatives.[320]

Although the devotion to improving American financial literacy is not new, "there has been a dramatic increase in the development and delivery of financial education programs" over the past decade.[321] Indeed, "[t]he collective response by public and private organizations to the . . . need for financial education has been impressive in size and scope."[322]

Various agencies within the federal government sponsor initiatives that include credit literacy components, such as: the Federal Deposit Insurance Corporation's (FDIC) "Money Smart" program,[323] the Department of Defense's "Financial Readiness Campaign,"[324] and the Federal Reserve's "There's a Lot to Learn about Money" campaign.[325] The FTC also "engages in several activities, including maintaining a Web site that features educational information on credit reporting and other financial topics and a toll-free number for complaints and questions."[326] Freddie Mac's CreditSmart® program[327] is a private-sector educational initiative, and "Fair Isaac Corporation maintains a Web site to disseminate information on credit education."[328]

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317. Jonathan Fox et al., *Building the Case for Financial Education*, 39 J. CONSUMER AFF. 195, 197 (2005).

318. *Id*. at 197-98.

319. *Id*. at 197.

320. *See id*. at 197, 199.

321. Fox et al., *supra* note 317, at 196.

322. *Id.* at 208.

323. *See Money Smart—A Financial Education Program,* FED. DEPOSIT INS. CORP., http://www.fdic.gov/consumers/consumer/moneysmart/index.html (last visited Nov. 19, 2013).

324. For an example of the U.S. Army's financial readiness website, see http://www.myarmyonesource.com/familyprogramsandservices/financialreadiness/default.aspx.

325. *See There's A Lot To Learn About Money,* FED. RES. EDUC., http://www.federalreserveeducation.org/resources/detail.cfm?r_id=db2c0d8c-a03d-4a95-9869-f9135bca1ee8 (last visited Nov. 19, 2013).

326. GAO REPORT, *supra* note 186, at 10; *see Consumer Information*, FED. TRADE COMMISSION, http://www.consumer.ftc.gov (last visited Nov. 19, 2013).

327. *See CreditSmart®,* FREDDIE MAC, http://www.freddiemac.com/creditsmart (last visited Nov. 19, 2013).

328. GAO report, *supra* note 186, at 10; *see Check your FICO® Score. Free.*, MYFICO, http://www.myfico.com/Guest_Home.aspx (last visited Nov. 19, 2013); *see also* Ron Lieber, *In College, Learning About Money*, N.Y. TIMES, Jan. 7, 2011, http://www.nytimes.com/2011/01/08/your-money/08money.html?pagewanted=1&_r=1 (describing initiative at Champlain College, in Vermont, requiring all

Financial-literacy education could be effective in the credit-reporting industry, because it has the potential to raise consumers' awareness of their basic rights, stress the importance of regular monitoring of credit reports, and teach consumers how to read and understand credit reports and improve their credit scores. These potential improvements have led to the establishment of the Financial Literacy and Education Commission (FLEC) within the FACT Act.[329]

The FLEC's stated purpose is "to improve the financial literacy and education of persons in the United States through development of a national strategy to promote financial literacy and education."[330] The FLEC is required to:

> [E]mphasize, among other elements, basic personal income and household money management and planning skills, including how to—
>
> (A) create household budgets, initiate savings plans, and make strategic investment decisions for education, retirement, home ownership, wealth building, or other savings goals;
>
> (B) manage spending, credit, and debt, including credit card debt, effectively;
>
> (C) increase awareness of the availability and significance of credit reports and credit scores in obtaining credit, the importance of their accuracy (and how to correct inaccuracies), their effect on credit terms, and the effect common financial decisions may have on credit scores;
>
> (D) ascertain fair and favorable credit terms;
>
> (E) avoid abusive, predatory, or deceptive credit offers and financial products;
>
> (F) understand, evaluate, and compare financial products, services, and opportunities;
>
> (G) understand resources that ought to be easily accessible and affordable, and that inform and educate investors as to their rights and avenues of recourse when an investor believes his or her rights have been violated by unprofessional conduct of market intermediaries;
>
> (H) increase awareness of the particular financial needs and financial transactions (such as the sending of remittances) of consumers who are targeted in multilingual financial literacy and education programs and improve the development and distribution of multilingual financial literacy and education materials;
>
> (I) promote bringing individuals who lack basic banking services into the financial mainstream by opening and maintaining an account with a financial institution; and

undergraduates to attend two financial literacy sessions).

329. *See* 20 U.S.C. § 9702 (2012).

330. *Id.* § 9702(b).

> (J) improve financial literacy and education through all other related skills, including personal finance and related economic education, with the primary goal of programs not simply to improve knowledge, but rather to improve consumers' financial choices and outcomes.[331]

These emphases are very broad; they are not limited to understanding credit reports and being aware of basic rights. Rather, they envision turning consumers into active market players who make strategic decisions about their own credit, insurance, and savings by comparing, for example, different products, understanding financial terms, and avoiding abusive offers.[332]

However, as the FLEC itself explains:

> Personal financial management is an extremely complex matter that requires significant resources and commitment by consumers to understand and evaluate the multitude of products available in the broad financial services market. . . . [T]he marketplace is constantly changing, with new products, services, and providers emerging to meet consumer demand. As a result, the range of topics and issues that consumers must evaluate is vast and ever-growing.[333]

Personal financial management in today's markets also requires "knowledge of concepts and terminology; . . . understanding of arithmetic calculations; comprehension of fractions, percentages, and probabilities; predictions about one's own future income, expenses, and health; and predictions about market factors . . . ."[334]

Given this complexity, is financial education effective? And, more importantly, can it be effective in today's markets?

2. The Limitations of Consumer Education

a. Doubtful Efficacy

Assessing the efficacy of financial-literacy education is not easy. Most studies "rely on participant self-assessments of whether a course changed their own knowledge, confidence, and behaviors."[335] This technique may be biased toward finding that education is effective, because people tend to "overestimate

331. *Id.* § 9703(a)(2).

332. *See* Willis, *supra* note 182, at 201. "The point isn't to turn the average American into Warren Buffet but to help people avoid disasters and day-to-day choices that eat away at their bank accounts." Surowiecki, *supra* note 141.

333. FIN. LITERACY & EDUC. COMM'N, TAKING OWNERSHIP OF THE FUTURE: THE NATIONAL STRATEGY FOR FINANCIAL LITERACY, at vii (2006); *see* Willis, *supra* note 182, at 212-19 (discussing information asymmetries).

334. Willis, *supra* note 182, at 219.

335. *Id.* at 205.

how much they have learned and how much their future behavior will change."[336] In one study, for example, consumers who attended retirement-related financial classes thought their literacy had increased, but their scores on financial tests did not improve.[337] In another study, employees who reported at the end of a retirement-investing seminar that they would increase their savings generally failed to do so.[338]

Willis mentions another methodological weakness: "Individuals who choose to attend personal-finance classes may be better informed or more motivated, may have more free time for researching and making financial decisions, may possess personalities more conducive to good money management, or may experience less embarrassment or denial stemming from past financial problems."[339] Indeed, recent experimental research documents substantial consumer selection effects. For example, one study found that consumers with more education, more financial knowledge, and lower financial-discount rates were more likely to accept an offer for a brief, free credit-counseling session.[340]

In addition, financial-education programs often omit evaluation as a component of their program design. Jonathan Fox et al. describe and outline a comprehensive evaluation framework in the hope that programs will make a commitment to the evaluation process.[341]

Putting methodological issues aside, evidence suggests that financial education programs must be regarded with "cautious optimism" as its positive effect is doubtful.[342] For example, Lusardi and Mitchell showed that people who were financially literate when they were young are more likely to plan for retirement during their working years.[343] However, "[d]ata from the Jump$tart nationwide survey of high-school seniors has consistently shown that financial

336. *Id*.

337. *See* Douglas A. Hershey et al., *Challenges of Training Pre-Retirees To Make Sound Financial Planning Decisions*, 24 EDUC. GERONTOLOGY 447, 467 (1998).

338. *See* James J. Choi et al., *Saving for Retirement on the Path of Least Resistance*, *in* BEHAVIORAL PUBLIC FINANCE 304, 335-37 (Edward J. McCaffery & Joel Slemrod eds., 2006).

339. Willis, *supra* note 182, at 207.

340. *See* Stephan Meier & Charles Sprenger, *Discounting Financial Literacy: Time Preferences and Participation in Financial Education Programs* 9-13 (Fed. Res. Bank of Bos., Pub. Pol'y Discussion Papers No. 07-5, 2008), *available at* http://www.bostonfed.org/economic/ppdp/2007/ppdp0705.pdf.

341. *See* Fox et al., *supra* note 317, 202-08.

342. *See* Richard M. Todd, *Financial Literacy Education: A Potential Tool for Reducing Predatory Lending?*, THE FED. RES. BANK OF MINNEAPOLIS (Nov. 1, 2002), http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=2466; s*ee also* Fox et al., *supra* note 317, at 199-202 (discussing impact of financial education); Mandell, *supra* note 140, at 1625 (explaining consumer unawareness).

343. *See* Annamaria Lusardi & Olivia S. Mitchell, *Financial Literacy and Retirement Planning: New Evidence from the Rand American Life Panel* 19 (Mich. Retirement Research Ctr., Research Paper No. WP 2007-157, 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1095869; *see also* Annamaria Lusardi, *Planning for Retirement: The Importance of Financial Literacy*, 19 PUB. POL'Y & AGING REP. 7, 10-11 (2009) ("Other studies have confirmed the positive association between financial knowledge and household financial decision making.").

education does not increase financial knowledge among high-school students and that students who take a personal-finance course 'tend to do a little worse . . . than those who do not.'"[344]

Education programs for adults have not fared better. "A study comparing bankruptcy debtors who received financial training with those who did not found that . . . the training was associated with a small negative effect on outcomes."[345] In another study, a large employer offered its employees the chance to switch from a defined-benefit to a defined-contribution plan.[346] To assist in such decision, the employer provided a free financial-education program.[347]

> The employer measured the effectiveness of this education by administering a before-and-after test of financial literacy. The quiz used a True/False format, so random answers would receive, on average, a score of 50 percent. Before the education, the average score of the employees was 54 [barely above chance]; after the education, the average score jumped to 55.[348]

Yes, as the authors noted: "teaching is hard."[349]

b. Predominant Biases

As mentioned above, various biases heavily sway consumer behavior. These biases, particularly overoptimism and self-control problems, are widespread in personal-finance decision-making.[350]

As an example of overoptimism, consider a 2005 survey, which found that approximately 65% of Americans believed they were "very" or "highly" knowledgeable about personal finance, although they performed abysmally on objective questions about personal finance.[351] Similarly, evidence comparing consumers' self-assessed credit histories and their actual credit histories has found overconfidence to be much more prevalent than underconfidence.[352]

Although effective financial education should reduce such widespread

344. Willis, *supra* note 182, at 208.

345. *Id.*

346. *See* Shlomo Benartzi & Richard H. Thaler, *Heuristics and Biases in Retirement Savings Behavior*, 21 J. ECON. PERSP. 81, 96 (2007).

347. *See id.* at 99.

348. *Id.*

349. *See id.*

350. *See* Willis, *supra* note 182, at 235.

351. *See National MoneyWi$e Survey Shows Americans Are Not Financially Fit*, CONSUMER ACTION (Sept. 6, 2005), http://www.consumeraction.org/press/articles/national_moneywie_survey_shows_americans_are_not_financially_fi.

352. *See* Vanessa Gail Perry, *Is Ignorance Bliss? Consumer Accuracy in Judgments About Credit Ratings*, 42 J. CONSUMER AFF. 189, 196-98 (2008).

overoptimism, most programs aim to increase consumers' confidence.[353] Additionally, financial education may lead to information overload, discounting its potential cure for poor decision-making.[354]

Unfortunately, biases are resistant to change, and people are often unable to recognize their biases and prevent them, even when made aware of them.[355] Not surprisingly, there is no evidence that education can actually change people's biases.[356]

c. Costs

Although financial education is relatively low in costs concerning market disruption, it is quite expensive with regard to out-of-pocket expenditures, labor, and time, especially if it aspires to be effective.[357]

Consider the FLEC, discussed previously. The FACT Act, which created the FLEC, authorized the appropriation of "such sums as may be necessary to carry out" its provisions.[358] The FACT Act also authorized a $3 million appropriation to the Secretary of the Treasury for fiscal years 2004, 2005, and 2006 in order to "develop, produce and distribute [a] multimedia campaign."[359] Since its inception, however, the FLEC has received no direct appropriation, and according to Treasury staff, the "Treasury has never requested funds specifically for the Commission [FLEC] in the President's budget request for the department."[360]

Naturally, there are implications for such limited resources. In accordance with its obligations under the FACT Act, the FLEC launched a toll-free hotline in 2004, which "serves as an order line for a free 'tool kit' of publications."[361] However, without sufficient funds to advertise this hotline, its usage "has been limited and does not appear to be increasing."[362]

The same can be said regarding the limited use of the special website that the FLEC established in accordance with the FACT Act "to serve as a clearinghouse and provide a coordinated point of entry for information about federal financial literacy and education programs, grants, and materials."[363]

353. *See* Willis, *supra* note 182, at 236-37.

354. *See supra* Part V.A.2.a.i.

355. *See* Willis, *supra* note 182, at 248-49.

356. *See id.* at 228.

357. *See id.* at 261-64.

358. *See* 20 U.S.C. § 9708 (2012).

359. *See* FIN. LITERACY & EDUC. COMM'N, U.S. GOV'T ACCOUNTABILITY OFFICE, PROGRESS MADE IN FOSTERING PARTNERSHIPS, BUT NATIONAL STRATEGY REMAINS LARGELY DESCRIPTIVE RATHER HAN STRATEGIC 13 (2009), *available at* http://www.gao.gov/assets/130/122383.pdf.

360. *Id.*

361. *Id.* at 10.

362. *Id.*

363. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 359, at 9; *About MyMoney.gov*, MYMONEY.GOV, http://www.mymoney.gov/Pages/About-Us.aspx (last visited Nov. 19, 2013).

According to the GAO, "[f]rom its inception [in 2004] through February 2009, the site received approximately 3,258,000 visits."[364]

Indeed, effective financial education is costly. Lauren E. Willis refers to additional costs, which are beyond time, monetary expenses, and inefficient division of labor. Willis argues that the focus on financial education diverts policy makers' and regulatory attention from the pursuit of potentially effective consumer-finance policies.[365] This criticism is less relevant to the credit-reporting industry, because education is only one component of a broader, regulatory regime.

However, Willis discusses two negative effects that can be relevant to the credit-reporting industry. First, the financial-education model may reinforce a "culture of financial self-blame."[366] Many consumers understand the financial education efforts "to mean that they have only themselves to blame for their financial woes."[367] The associated "stigma leads [consumers] to keep their problems to themselves, rather than seeking help," which may potentially lead to psychological and physical health problems.[368] The second negative effect is misinterpretation of the newly learned material, which can backfire by increasing the stakes and, thus, mistakes.[369]

Financial education can be very beneficial to consumers in the credit-reporting system. However, its efficacy is still doubtful and it can impose substantial costs that need to be taken into consideration. Although some good research has been conducted in this field, more must be carried out to explore the most cost-effective ways of educating consumers in the credit-reporting system.[370]

VI. CONCLUSION

This Article has attempted to illustrate that the average consumer is different from the image depicted by the current regulations. The FCRA envisions rational and vigilant consumers, and imposes various monitoring responsibilities on those consumers. However, research in behavioral economics demonstrates how consumers' decision-making processes can be irrational because they are biased by numerous judgment errors. The FCRA,

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364. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 359, at 9.

365. *See* Willis, *supra* note 182, at 264-72 (discussing regulatory opportunity costs).

366. *Id.* at 260.

367. *Id*. at 279.

368. *See id*. at 260, 279.

369. *See* Willis, *supra* note 182, at 274-75. Intriguingly, uneducated assumptions can sometimes lead to better outcomes. One study shows that borrowers who overestimate their creditworthiness as compared to their credit scores appear to receive better prices on home mortgages than those whose self-assessments are closer to their credit scores. *See* Marsha Courchane et al., *Consumer Credit Literacy: What Price Perception?*, 60 J. ECON. & BUS. 125, 137 (2008).

370. *See* FIN. & EDUC. LITERACY COMM'N, *supra* note 333, at xii. "[R]esearch is essential in developing and replicating programs that are proven to achieve results and to ensure the efficient use of resources." *Id.*

by charging consumers with the burden of responsibility but providing no tools with which to manage such responsibility, has failed to grasp the complexity of consumer behavior. The gap between real consumers and the *homo economicus* envisioned by the FCRA can explain, at least partially, the failure of the current regulations to substantially reduce, if not eliminate, credit report inaccuracies; reduce identity theft; and prevent manipulation through marketing lists.

Although numerous potential solutions can be offered to solve these consumer problems, this Article has focused on two specific solutions that may fit into the behavioral-economic approach. The challenge is to combine different mechanisms in order to achieve maximum consumer protection at minimum costs, without undermining the voluntary nature of the credit-reporting system.

Special attention should be given to "choice architecture," because even minor changes in the form of disclosure, framing, and defaults may have a dramatic effect on consumers' behavior. Further experimental data is paramount in working out the optimal form of "choice architecture" in the credit-reporting system.

Financial education can also be beneficial to consumers in the credit-reporting system. Potentially, financial-literacy education can serve to raise consumers' awareness of basic rights, stress the importance of regular monitoring of credit reports, and teach consumers how to read and understand credit reports and improve their credit scores. However, further research must be carried out to explore the most cost-effective ways of educating consumers in the field.

The new Bureau of Consumer Financial Protection (Bureau), which was established under Title X of the Dodd-Frank Act,[371] has the potential to facilitate such research and significantly improve consumer protection. The Bureau has recently proposed new regulations under which CRAs with receipts exceeding $7 million would face federal supervision.[372] The near future will tell if a real change in consumer protection can be achieved, or whether the hopes and expectations associated with the new Bureau were unrealistic.

371. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1011(a), 124 Stat. 1376, 1964 (2010).

372. *See* Defining Larger Participants in Certain Consumer Financial Product and Service Markets, 77 Fed. Reg. 9592, 9603-05 (Feb. 17, 2012) (to be codified at 12 C.F.R. pt. 1090).