



National **Retail** Federation
The Voice of Retail Worldwide

**Testimony of William Hough
Vice President of Credit Services
The Neiman Marcus Group
Dallas, Texas**

on behalf of the

**National Retail Federation
before the**

**Senate Banking Committee
June 19, 2003**

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**PREPARED STATEMENT OF WILLIAM HOUGH
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DALLAS, TEXAS
REPRESENTING THE NATIONAL RETAIL FEDERATION**

Good afternoon. My name is Bill Hough. I am Vice President of Credit Services for the Neiman Marcus Group. I am testifying today on behalf of the National Retail Federation. I would like to thank Chairman Shelby and Ranking Member Sarbanes for providing me with the opportunity to testify before the Banking Committee about the growing problem of identity theft and the steps that Neiman Marcus is taking to curb our losses and protect our customers from these crimes.

By way of background, The Neiman Marcus Group is Headquartered in Dallas, Texas and is comprised of two primary operating segments: Specialty Retail (which includes 35 Neiman Marcus stores nationwide and two Bergdorf Goodman stores in New York City) and Direct Marketing (which includes the catalogue and online operations for our Neiman Marcus, Horchow and Chef's brands). We issue our proprietary credit cards under the Neiman Marcus and Bergdorf Goodman names.

The National Retail Federation (NRF) is the world's largest retail trade association with membership that comprises all retail formats and channels of distribution including department, specialty, discount, catalogue, Internet and independent stores. NRF members represent an industry that encompasses more than 1.4 million U.S. retail establishments, employs more than 20 million people—about 1 in 5 American workers—and registered 2002 sales of \$3.6 trillion.

In fiscal 2001, Neiman Marcus reached a high-water mark for identity theft related losses with just over 520 cases representing a total expense of \$1.3 million. In the past two years, we have experienced a decline of approximately 70 percent in the number of identity theft fraud cases with less than 150 cases projected for the current year. It is

important to note that cases involving other forms of fraud, such as lost or stolen cards have remained constant over the past two years.

Mr. Chairman, instant credit represents about 85 percent of all new accounts opened at Neiman Marcus. As you know, this process is most likely to take place at the point of sale and relies on a highly automated and relatively quick procedure to verify an applicant's identity and check that individual's credit report. In order to cut down on fraud and identity theft during the instant credit application, Neiman Marcus developed a custom fraud detection model that analyzes certain specific attributes of every credit application. This system isolates certain variables on an application and double-checks them against the information found on the applicant's credit report. Where discrepancies or inconsistencies occur, the model sends the application to our Credit Department for further review. Clearly, the model we developed works well and has reduced our losses significantly over the past two years. Additionally, another positive byproduct of the model is that it has identified and prevented many more identity theft cases (about 800 in the past year).

Occasionally, we are able to definitively detect an attempted fraud and arrest the identity thief in our store. This usually occurs if our credit office, after being alerted during the application process, can quickly get in touch with the victim by calling a phone number that was provided through the credit bureau information. We will then ask if they want to pursue an arrest of the person attempting to use their personal information to open a credit account. If they agree, we will authorize a credit card number and allow the clerk to open the account and complete the transaction. At that point, Neiman Marcus Loss Prevention will detain the suspect and contact the police. We have had 33 such arrests this year, and 80 in 2002.

Another program that Neiman Marcus has used to dramatically cut down on fraud is administered through our Direct Marketing division. Currently, Neiman Marcus Direct packs and ships approximately 10,000 packages per day for our Neiman Marcus, Horchow

and Chef's brands. We also ship about 5,000 packages from our specialty retail stores each day. By using customer information-sharing we were able to develop an address delivery cross-check within our Delivery Manifest System. Thus, each package is passed through this address verification to make sure it is not going to a known bad delivery address. Additionally, edits are in place to identify unusual buying patterns that may be forwarding merchandise to a certain address. These controls stopped over 500 fraudulent shipments last year.

Neiman Marcus also does special edits to focus on the hottest selling merchandise, knowing that these items often have the highest street sale value. In fact, a savvy sales clerk at the Neiman Marcus in White Plains, New York helped to expose one of the largest identity theft rings in U.S. history involving a former employee of Teledata and over 30,000 stolen credit reports from the three major credit bureaus. The incident began when a woman called in an order for \$6,000 in trendy shoes to the White Plains store and told the sales clerk she didn't care what size shoes were shipped to her. The sales clerk realized this was a suspicious transaction and notified the Loss Prevention department at Neiman Marcus who helped set up a controlled delivery with local law enforcement and the U.S. Postal Service.

Mr. Chairman, I would like to be able to tell you that Neiman Marcus has prevented 100 percent of all fraudulent credit applications this year, but I can't. Successful identity thieves still slip by our systems at a rate of 7 per every 10,000 applications processed – less than one-tenth of one percent. This, in my view, is not the result of a flawed system, but the result of determined criminals with sophisticated tools like computers and the Internet. You see, the most successful identity thieves know how to replicate an individual's verifiable identity characteristics, including producing near-perfect identity documents such as state-issued driver's licenses and counterfeit credit cards.

Thieves are always looking for the weakest link in any system in order to perpetrate a crime. Today, identity theft and unauthorized access to existing accounts (such as

unauthorized account look-up or account takeover) seem to be the name of the game. Both of these crimes rely on being able to present yourself using someone else's identity information. For these types of criminals there is very little else we can do to detect and prevent the crime, and retailers, like other businesses, are looking to the states and the federal government to begin producing the most secure and fool-proof identity documents possible. Some have proposed the use of biometrics or magnetic strip authentication to verify an individual's identity. Whatever the mechanism, it behooves retailers, banks and governmental bodies alike to make identity security a top priority. In fact, the NRF is in the beginning stages of creating a public-private partnership to focus on identity security and its implications for both preventing identity theft as well as helping victims put their credit records back together again.

The need for tougher law enforcement statutes is critical. While we will arrest approximately 250 fraud perpetrators this year, many of these criminals are out on the street the next day with a slap on the wrist. It is almost as though they are being treated as a harmless pickpocket versus a serious criminal who has created havoc for an innocent victim. These people, especially those that become multiple offenders, must face stiffer sentences if we are going to stop this type of crime.

With identity theft representing such a small fraction of total credit applications, it is often a case of looking for a needle in a haystack. Further, identity thieves thrive on anonymity and rely on the assumption that large retailers such as Neiman Marcus cannot put a name and face together in order to prevent fraud. This is why it is so important for retailers to know their customers, and the only way we can do this is through the use of information. Information flows between Credit Services and the credit bureaus or between our Retail Division and Direct Marketing Division, combined with sophisticated technology and scoring models, cuts down on fraud and allows us to offer exceptional customer service. These two benefits are not mutually exclusive and the type of information we collect from each customer and its uses is explained clearly in the Neiman Marcus Security and Privacy policy that can be found Online at www.NeimanMarcus.com.

At Neiman Marcus, we also have a Fraud Unit that specializes in handling all types of fraud claims. These associates are specially trained to assist and guide identity fraud victims through a very complicated ordeal. In fact, a call from our Fraud Unit can be the first indication that a consumer may have of suspicious activity on their account or of a potential identity theft in progress. You can be sure that if an identity thief is trying to open accounts in our store, they are probably attempting to do the same thing at several other locations as well.

Identity theft is a crime with at least two victims, the individual whose identity was stolen and the business from which money or merchandise was stolen. Clearly, it is the individual victim that is most directly hurt, but, if identity theft crimes continue to rise at the rate reported by the FTC, all consumers will ultimately pay as business losses are passed back to customers. We at Neiman Marcus are convinced that our systems are making a difference, but we also do not intend to sit on our hands waiting for criminals to find the next weakest link. Mr. Chairman, I ask that Congress think carefully before blocking information flows or constraining businesses to specific prevention techniques or responses. We in business must continue to have the leeway to innovate to respond to constantly changing variables. Criminals always find a way and we need to maintain the ability to find a response.

In closing, I would like to emphasize the retail industry's strong support for the permanent reauthorization of the seven areas of preemption contained in section 624 of the Fair Credit Reporting Act. The current uniform national standards allow retailers and lending institutions to get a complete and accurate picture of a person's credit history as well as prevent fraud and identity theft. Consumers have come to expect efficient and secure access to credit when purchasing everything from an automobile to consumer goods such as furniture, appliances and apparel. In the final analysis, we in the retail industry have a real concern that a more fragmented approval processes for credit would negatively impact consumers in many different levels and, as a consequence, retail sales, ultimately costing jobs and hurting the economy as a whole.

I appreciate the opportunity to testify here today. I look forward to answering your questions as well as those of the Committee. Thank you.