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ON BEHALF OF
THE U.S. CHAMBER OF COMMERCE

BEFORE THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

"ADDRESSING MEASURES TO ENHANCE THE OPERATION OF THE FAIR CREDIT REPORTING ACT"

July 31, 2003

Good morning, Mr. Chairman, Senator Sarbanes, and Members of the Committee. My name is Michael F. McEneney and I am a partner at the law firm of Sidley Austin Brown & Wood LLP. I am pleased to have the opportunity to appear before you today on behalf of the United States Chamber of Commerce. The U.S. Chamber serves as the principal voice of the American business community here in the U.S. and around the world. Specifically, the Chamber is the world's largest business federation, representing more than three million businesses of every size, sector and region of the country.

The FCRA has provided a robust framework for the most advanced consumer credit and insurance markets in the world. A key component of this success is the fact that the FCRA establishes a single national system in which our credit and insurance markets can operate smoothly. This has resulted in significant consumer benefits, in the form of increased credit and insurance availability at lower costs, and has provided a source of strength for our economy. The national uniformity of key provisions in the FCRA is currently scheduled to expire on January 1, 2004. Making these provisions permanent has been a high priority for the Chamber and its member companies. We urge the members of the Committee to make these provisions permanent. As discussed below, the system works extremely well, and we believe the 7-year experiment with national uniformity has been a success and the uniformity should be made permanent.

The Economic Importance of National Uniformity

At the beginning of the Committee's deliberations on these issues, there were a number of questions raised about the significance of the national uniformity established by the FCRA. A recent study entitled "The Fair Credit Reporting Act: Access, Efficiency & Opportunity" goes a long way to answering those questions. The study was prepared by the Information Policy Institute ("IPI") with the support of the National Chamber Foundation of the U.S. Chamber of Commerce. The aim of the study was to examine specifically whether a loss of the existing framework of preemption would threaten the benefits of our credit markets currently enjoyed by consumers. This study relied on hard data to determine the impact on consumers and industry if the national uniform standards were lost. I would like to share some of the study's findings with the Committee.

In General

In all areas of inquiry, the IPI found that the national uniform standards established by the FCRA have contributed significantly to the consumer benefits of the current credit marketplace. Further, the IPI found few quantifiable direct or indirect costs to consumers associated with the national uniform standards. The study concluded that the loss of the existing framework of preemptions would threaten the current consumer benefits, and that congressional action is necessary to ensure the continuity of our national standards.

Mortgages

The study recognizes that many of the efficiencies developed by the mortgage underwriting market, such as automated underwriting, are made possible, at least in part, by the national uniformity established by the FCRA. According to the study, automated underwriting consistently does a better job of identifying loans that ultimately "perform"—loans that do not experience a serious delinquency or default. Moreover, automated underwriting allows mortgage underwriters to accommodate high volumes of activity. For example, in 2002, the Federal Reserve estimates that homeowners were able to gain access to approximately $700 billion of equity in their homes—an astounding figure that may not have been possible under a less efficient system. The introduction of mortgage underwriting efficiencies, which have resulted in part from the national uniformity established by the FCRA, also appear to have significantly reduced the costs of closing a loan, saving consumers at least $18.75 billion in 2002.

Credit Availability

The study also examined four different scenarios under which the FCRA's national uniformity was allowed to expire and the FCRA's operative provisions were modified in ways suggested by existing legislative proposals in various states. The study examined the impact of these changes on six different commercial credit scoring models in order to approximate the impact on consumers and the cost of credit. In all four scenarios, the study found that loan approval rates would decrease or delinquencies would increase, resulting in increased costs to consumers. Furthermore, the predictive power of credit report information would decline, damaging creditors' ability to evaluate credit risk. If creditors cannot properly evaluate credit risk, one of two things generally occurs in order to hedge against that increased risk—creditors make less credit available, or they increase the cost of credit. Either way, consumers lose if the FCRA's national uniform standards expire.

Prescreening

The study evaluated the current practice of "prescreening" customers for preapproved offers of credit. According to the study, increased competition which has been driven in part by prescreening has caused interest rates to be lower overall than they were in 1990. The study also found that prescreening was the most important method of acquiring new credit card customers, and that restrictions on prescreening would increase costs to consumers, and decrease consumers' access to unsecured credit.

The Importance of National Uniformity to the Security of Consumers' Personal Information

The Chamber shares the Committee's goals of providing for continued access to credit as well as protecting the security of consumers' personal information. The national standards established by the FCRA are an important component of protecting the security of consumers' personal information. For example, the national uniform provisions under the FCRA ensure that financial institutions can have access to reliable credit report information for a variety of purposes, including identity theft prevention. Indeed, the important role credit reports can play in the efforts of financial institutions to verify the identity of their customers has been recognized as part of the regulatory efforts to implement the customer identification provisions of the USA PATRIOT Act.

The national uniform standards also allow companies to prevent identity theft in more subtle ways. Under the FCRA, companies have a single federal standard governing their ability to share information among affiliated entities. A key purpose for the sharing of information among affiliates is to prevent fraud, including identity theft. The FCRA also establishes a uniform standard for prescreening consumers for credit. It is noteworthy that the fraud rates, including identity theft, are significantly lower on accounts acquired through prescreening than accounts acquired through other means. Providing states the opportunity to enact their own prescreening rules would make this more secure method of customer acquisition less attractive if not impossible.

The national standards established by the FCRA also ensure that consumers have the tools necessary to protect themselves against identity theft. For example, consumers are provided a standardized notice if they are the subject of adverse action based on a consumer report. This notice, which is uniform across the country, informs the consumer of the adverse action and notifies the consumer that the action was based, at least in part, on information from a credit report. This is a "red flag" to the consumer to check the credit report to ensure its accuracy. Furthermore, the FCRA establishes a single timeframe under which credit bureaus have to reinvestigate any consumer disputes. I think we can all agree that it is challenging enough for credit bureaus and consumers to resolve identity theft issues under a single set of rules—imagine the difficulty if credit bureaus had to comply with different rules depending on where the consumer is located.

The Practical Application of the FCRA to Underwriting

Although the broad concepts I have discussed to this point are important, I would like to provide a more practical application of how the credit reporting and underwriting process thrive under the FCRA. The concept of credit underwriting, or the analysis of economic risk on which a decision to lend money is based, has received repeated mention by virtually all sides of the debate, but at no point have we really stopped to talk about what that means. I have attached an example to my testimony consisting of two simple revolving loan portfolios, each containing

100 loans of $1,000 apiece, and each paid off within a year. One portfolio has an interest rate of 5 percent, the other a rate of 18 percent.

If one loan in the 5 percent portfolio were to immediately default (whether because of identity theft, consumer bankruptcy, or poor judgment on the part of the lender), it would take the interest payments from 41 performing loans to compensate for that default. If, instead, as few as three borrowers default, the lender is completely underwater -- and will lose money -- even before facing the expense of managing 97 other loans. If one loan in the 18 percent portfolio defaults, it takes the interest from 12.11 performing loans to compensate for that one default. Even if the lender gets it exactly right 92 percent of the time, no matter how well those 92 consumers pay their bills, the lender is in serious trouble.

There is not much more to underwriting than that. And this is why it is so important for lenders to be able to assess credit risk accurately. The complicated part occurs when trying to fit the maximum number of borrowers into the continuum of rates between 5 and 18 percent while keeping defaults to a minimum. Whoever does the best job of fitting borrowers to a particular interest rate attracts the most customers because they can offer the lowest rate and manage their defaults so that they still make money. Anything that enhances this process has obvious consumer benefits. Since 1996, the seven preemptions of the FCRA have enabled lenders, at a national level, to take advantage of technological advances to serve their customers while greatly refining their ability to fit the right borrower into the right rate.

Issues Addressed as Part of the FCRA Debate

With this backdrop in mind, it appears that problems with the credit reporting process generally occur around the margins of the system. Although this Committee has heard compelling anecdotal testimony with respect to some of the glitches in the process, the Chamber urges the Committee to keep the larger picture in mind. The current system incontrovertibly does an excellent job of expeditiously providing a large volume of credit to an ever-increasing population of consumers. Drastic changes to the FCRA in an attempt to address these relatively small, although sometimes compelling, issues may result in excessive costs without providing concrete improvements for the discrete population that experiences difficulty.

It may be helpful for the Committee to review various statistics regarding actual consumer complaints pertaining to the FCRA so that Senators can more fully understand the scope of consumer difficulties associated with the FCRA. A review of consumer complaints received by various federal regulators and enforcement agencies over the past several years indicates that the protections implemented as part of the 1996 amendments to the FCRA are having the desired effect. We offer the following facts for the Committee's consideration: **[need more info on underlying statistics before including these stats in final version.]**

- **[**Between 1998 and 2002, complaints involving "credit bureaus" DECREASED from 15.25% of all complaints received by the Federal Trade Commission ("FTC") in 1998 to 3.53% received in 2002;

- Between 1998 and 2002, complaints to the FTC involving "credit information furnishers" DECREASED from 5.29% of all complaints to 3.01%;

- Between 1998 and 2002, complaints to the FTC involving "users of credit reports" DECREASED from 0.93% of all complaints to 0.37%; and

- Between 2000 and 2002, the Federal Deposit Insurance Corporation ("FDIC") received only 156 valid complaints pertaining to the FCRA, which is a staggeringly low number relative to millions of FCRA-related transactions occurring during this time period. **]**

These numbers present powerful evidence that despite the increase in credit growth since 1996, the actual consumer complaints relevant to the FCRA and the credit underwriting process are relatively small. While the Chamber is not suggesting that improvements cannot be made to the current law, we do believe it is critically important to keep the issue in the proper perspective.

Potential Issues for Enhancement

Identity Theft

One issue that deserves serious consideration is identity theft. Although identity theft is not caused by the FCRA, we believe the FCRA can certainly provide part of the solution. In general, we believe that there is a common theme that should guide the Committee in its consideration of provisions to combat identity theft. More specifically, the Chamber believes that the methods used to address potential identity theft scenarios should be flexible, allowing companies to utilize the means most efficient to them to thwart identity thieves. Indeed, a "one size fits all" approach may not work—the challenges presented by identity thieves will invariably change over time and the tools used to combat the thieves should change as well.

The Chamber is concerned that if the methods for preventing identity theft are "written in stone," companies will be forced to devote resources to complying with these methods, regardless of whether they become outdated or if more efficient alternatives become available. Furthermore, if companies must adhere to specific statutory requirements with respect to identity theft, it may become difficult for companies to alter their procedures in light of the constantly evolving nature of identity theft.

Consumer Education/Enforcement

Much of the anecdotal information regarding concerns about accuracy in the credit reporting systems arises in the context of consumers who detect potentially inaccurate information but are unable to get it corrected. The FCRA already provides powerful tools designed to allow consumers to correct information in their file by allowing every consumer to access his or her credit bureau files, dispute inaccurate information, and demand that the furnisher of the information participate in the reinvestigation. Once information is deleted from the consumer's file as a result of a reinvestigation request, the information cannot be reinserted unless the person providing the information to the credit bureau certifies that it is complete and accurate, and the consumer is notified by the credit bureau that the information has been reinserted. These and other tools established by the FCRA provide fairly comprehensive accuracy protection for consumers. One approach to enhancing the efficacy of the FCRA as an implement of promoting accuracy in credit reporting files would be to better educate consumers regarding their rights under the FCRA and how to exercise those rights. We believe that many of the problems experienced by consumers with respect to accuracy could be fully addressed through proper application of the existing provisions of the FCRA. The more consumers know about how to utilize those existing provisions, the more effective the FCRA itself becomes. Of course, there may be instances where participants in the system fail to adequately exercise their responsibilities. Once again, the existing provisions of the FCRA provide a remedy. It may be useful to explore how to ensure that the enforcement of those remedies takes place.

Access to Credit Reports

It is important for a consumer to have access to his or her credit report in order to ensure the report's accuracy, as well as to address any instance of identity theft as soon as possible. The FCRA currently ensures that access to credit reports is relatively inexpensive—the cost is capped by law at $9. In addition, the Chamber strongly supports the provisions in current law that provide consumers with access to their credit report at no charge in certain situations. For example, a consumer can obtain his or her credit report for free if the consumer: (i) has been the subject of "adverse action" (*e.g.* denial of credit) due in part to information in a credit report; (ii) is unemployed and intends to apply for employment; (iii) is a recipient of public welfare assistance; or (iv) has reason to believe that the file on the consumer at the credit bureau contains inaccurate information due to fraud, including identity theft.

Aside from the numerous instances when a consumer currently can obtain a copy of a credit report for free, some have advocated providing consumers with a credit report at least once annually at no charge. The Chamber welcomes the consideration of how to make credit reports more available to consumers. We believe, however, that this issue merits careful study before next steps are taken. In particular, there should be a careful examination of the costs associated with a "free" credit report in order to ensure that there are no unintended consequences. For example, the costs of providing free reports and the related customer service will have to be absorbed by the consumer. Moreover, resources that are currently dedicated to investigating potential errors in consumer reports, or assisting consumers with resolving identity theft claims, will need to be redirected to meet the demand for "free" credit reports. It should also be noted that a single, well placed national news article or widely circulated e-mail could create significant spikes in demand for credit reports that simply could not be met without severe disruption to the other important customer service functions performed by credit bureaus.

Investigating Wrongdoing in the Workplace

Currently, the broad definitions of "consumer report" and "consumer reporting agency," as interpreted by the FTC, appear to apply if an employer uses outside experts to investigate employee misconduct. This results in the outside firm, such as an accounting firm or law firm, potentially becoming a consumer reporting agency for purposes of the FCRA. Because of the difficulties in conducting an investigation while complying with the FCRA's requirements, and because employers and investigators face significant potential liability, including punitive damages, for failure to comply with the FCRA's requirements, the FTC's interpretation deters employers from using experienced and objective outside organizations to investigate workplace misconduct. While the FTC's interpretation affects all businesses, it is particularly damaging to small and medium businesses that do not have in-house resources to conduct their own investigations.

The Chamber strongly believes that Congress should take this opportunity to remedy this problem. We urge the Committee to adopt legislation that would exclude employment investigations which are not for the purpose of investigating the employees' creditworthiness from the FCRA requirements. I want to stress that this provision would be a narrow correction of an obvious problem created by current interpretation of the law. In addition, the legislation should not leave those suspected of misconduct without protection—it should require that employers who take adverse action against an employee based on information from an investigation provide the employee with a summary of the nature and substance of the report.

Conclusion

Once again, I would like to thank the Committee for its diligent efforts in examining ways to maintain the consumer benefits of our current financial marketplace while also protecting the security of consumers' personal information. The Chamber strongly endorses the criteria suggested by Treasury Secretary Snow that any amendments to the FCRA affecting the credit reporting or credit underwriting process should enhance both personal data security and access to and availability of credit. Our recommendations are made with this formulation in mind. The Chamber looks forward to working with you, Mr. Chairman, and with other Members of the Committee as your efforts to amend the FCRA progress.

Thank you again for the opportunity to appear before you today. I would be happy to answer any questions you may have.