Consumer Federation of America

TESTIMONY OF

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BEFORE THE

SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

REGARDING

CONSUMER AWARENESS AND UNDERSTANDING OF THE CREDIT GRANTING AND REPORTING PROCESS

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Good morning Chairman Shelby, Ranking Member Sarbanes and the members of this Committee. My name is Travis B. Plunkett and I am Legislative Director of the Consumer Federation of America.[1] Thank you for this opportunity to offer our comments on consumer awareness and understanding of the credit granting and reporting process. We have been involved for many years in efforts to increase the transparency and effectiveness of the credit reporting system for consumers.

I applaud the Committee for conducting a hearing on such an important – and little understood -- subject. The hearing is very timely for several reasons. First, unless consumers understand the credit reporting system and have access to clear, timely information, they won't be able to use the rights granted to them under the Fair Credit Reporting Act. The Act expects a great deal from consumers because significant protections are only triggered if consumers take narrowly defined actions. For example, if a consumer doesn't know to contact a credit bureau to trigger a reinvestigation of credit reporting problem, he or she might waste valuable time contacting his or her lender and never get the problem resolved. This is because, as you know, the lender is currently under no legal obligation to begin a reinvestigation unless contacted by a credit bureau.

Secondly, with the advent of "risk-based pricing" in the last decade, the way that credit is granted in this country has changed dramatically, but information provided to consumers under the FCRA about the nature of these loans has not kept up with this change. These days, a consumer with some credit blemishes is much more likely to be offered a higher-cost loan with less favorable terms that to be denied a loan. Misclassification as a high-risk, sub-prime borrower because of a credit report error or incomplete reporting by a furnisher (creditor) can cause consumers to pay tens or hundreds of thousands of dollars in higher interest rates. CFA's report on credit score accuracy issued last December found that eight million Americans are likely to be misclassified as sub-prime upon applying for a mortgage, based on the study's review of credit files for errors and inconsistencies.[2] And yet, millions of consumers have no way of knowing that this has occurred, because under the "counter-offer" loophole in the FCRA, they do not receive an adverse action notice and are not granted the right to look at their credit report at no charge and check for inaccuracies.

And finally, there has never been greater need for Congress to discuss how it can help boost overall financial awareness and improve financial decision-making by Americans, especially in regards to the credit reporting and credit granting process. For three decades, our

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[1] CFA is a nonprofit association of 300 pro-consumer organizations that, since 1968, has sought to advance the consumer interest through education and advocacy.

[2] Consumer Federation of America and National Credit Reporting Association. *Credit Score Accuracy and Implications for Consumers*. December 2002. Available at: http://www.consumerfed.org/121702CFA_NCRA_Credit_Score_Report_Final.pdf

organization has sought to improve financial "literacy" among the public and to promote effective financial education.

In response to the invitation to testify at this hearing, the Consumer Federation of America commissioned a study about consumer knowledge of credit reports and scores and the level of public support for a variety of protections that this Committee may consider. More than 1,000 adults were interviewed.[3] We found that a strikingly high percentage of Americans not only do not understand basic facts about credit reports and scores, but also acknowledge their own lack of understanding about the subject. This recognition, and awareness of the growing importance of credit scores, may explain why the survey found overwhelming support for new consumer protections. An important finding of the survey is also that low- and moderate-income Americans -- those who tend to pay the highest price for credit and are most vulnerable to inaccurate credit scores -- are the least knowledgeable about credit reports and scores.

## Most Americans Say They Don't Understand Credit Reports and Scores Well

When asked to assess their knowledge of credit reports and credit scores, most Americans say their knowledge is "fair" or "poor." Fifty percent said their knowledge of credit reports was fair or poor, while 61 percent said their knowledge of credit scores was fair or poor.

Lower-income Americans are those most likely to believe their knowledge is not good. More than 60 percent of those in households with incomes under $35,000 said their knowledge of credit reports was fair or poor. Nearly seventy percent of these low- and moderate-income Americans said their knowledge of credit scores was fair or poor.

Young adults between the ages of 18 and 24 were also likely to say their knowledge was not good. Sixty-two percent said their knowledge of credit reports was fair or poor, while 78 percent said their knowledge of credit scores was fair or poor.

## Many Americans Lack Essential Knowledge About Credit Reports and Scores

The survey also tested actual consumer knowledge about credit reports and scores. Only 25 percent of Americans -- and less than 20 percent of those with incomes below $35,000 -- said they knew what their credit score was. And only three percent of Americans could, unprompted, name the three main credit bureaus -- Experian, Equifax, and Trans Union -- that provide both lenders and consumers information from credit reports. Forty-three percent of Americans -- only 35 percent of those with incomes below $35,000 -- said they had obtained a copy of their credit report from the three credit bureaus in the past two years.

The survey also tested consumer knowledge using a series of true-false questions. The good news from this test is that large majorities understand that consumers have the right to see their credit report (97 percent) and that consumers who fail to qualify for a loan have the right to

[3] The survey was conducted by Opinion Research Corporation International. ORCI interviewed a representative sample of more than 1,000 adult Americans from July 18 to 21, 2003. The survey's margin of error is plus or minus three percentage points.

a free credit report (81 percent). The bad news is that many consumers do not understand that in most states they must pay a fee to obtain their credit report (54 percent), that their credit score may be lowered if they use all of the credit available on their credit card (55 percent), that their credit score may be lowered if they apply for a credit card (62 percent) and that they are not required to contact their lenders if they believe that their credit report or score is inaccurate (64 percent). Also, 27 percent incorrectly believe that their credit score mainly measures their knowledge of consumer credit, not their credit-worthiness.

Finally, the survey tested knowledge about which service providers often use credit scores to decide whether consumers can purchase a service or at what price. Many Americans are not aware that certain service providers frequently use these scores -- 60 percent were not aware that electric utilities do so, 41 percent for home insurers, 41 percent for landlords, and 38 percent for cell phone companies. By comparison, only 13 percent did not know that credit card companies use credit scores.

## Large Majorities Support Stronger Consumer Protections

The survey also questioned Americans about their opinions on new consumer protections currently being considered by Congress. The protections would give consumers greater access to their credit reports and scores, and strengthen individual remedies that they could pursue. The protections would also require credit bureaus to do a better job of verifying consumer identities and would proscribe certain lender practices.

Large majorities indicated their support for these protections.

Credit bureaus should do a better job of verifying identities on credit applications to reduce identity theft.
**96% support, 83% strongly**

Consumers who are denied a loan or charged a high price should be able to get from the lender a free copy of the credit report and score used as the basis for the lender's decision.
**94% support, 78% strongly**

A bank should not be allowed to use your medical information to make credit decisions without your consent.
**87% support, 77% strongly**

A bank should be required to obtain your permission before it can share your financial information with other companies it owns.
**91% support, 76% strongly**

Consumers should be able to obtain a free credit report and score once a year from the three main credit bureaus.
**91% support, 71% strongly**

Consumers should be able to sue lenders who knowingly provide credit bureaus with incorrect, damaging information.

**84% support, 62% strongly**

A credit card lender should not be allowed to raise the interest rate because of a credit problem that involves another lender.

**75% support, 52% strongly**

The cumulative effect of the extremely broad support for these proposed reforms is nothing less than a mandate for a comprehensive overhaul of the Fair Credit Reporting Act. Consumers want easier access to their credit reports and scores, greater protections against privacy and credit reporting abuses and the right to go after lenders in court who repeatedly make grievous errors.

## Empowering Consumers through Reforms to the Fair Credit Reporting Act

Given the relatively low levels of knowledge about credit reporting and scoring reported by the survey, it is especially important that Congress improve the transparency of the credit reporting system. We also strongly recommend that Congress overhaul the cumbersome and out-of-date procedures under FCRA for resolving disputes between consumers and credit bureaus, and between consumers and data furnishers, such as credit card companies.

**First, give consumers more information**. Information, provided in a clear manner and on a timely basis, is the key to improving consumer knowledge of the credit reporting process. Our recommendations will provide consumers with more information about their credit reports and scores in two ways: (1) on an ongoing basis – so that consumers can eliminate inaccuracies and prevent problems before they occur – and, (2) when credit troubles arise because of a credit report, such as the denial of a loan or an offer to extend credit on less than favorable terms.

- **Credit bureaus should be required to provide consumers with their credit reports <u>and</u> their credit scores once a year upon request at no charge.** They should be given a description of the major factors that are used to calculate the score, the weight of each factor in calculating the score and how the consumer rated on each major factor. Free credit reports, once a year upon request, are currently required in legislation that has just moved to the House floor (H.R. 2622) but the bill does not require free access to the score. Charging a fee for credit scores will not only mean that fewer consumers will learn their score, but it undercuts the goal of offering the report at no charge, since reports and scores are often marketed to consumers as a package product. Also, disappointingly, the full committee accepted an amendment to limit provision of the free credit report annually on request to the national repositories. The original version of the bill would have required all credit bureaus to provide a free credit report on request.

- **Congress should mandate that these reports be easy to get,** perhaps through the establishment of a registry at the Federal Trade Commission that will allow consumers to call or e mail one location and get a copy of their reports from all three major credit bureaus. Consumers should not be limited to making requests only by mail, or have deal with a complicated and time-consuming voice mail system, or have to click through page after page of information online simply to get access to a free report. Credit bureaus could easily undermine the goal of improving consumer access to their reports and scores if they make it cumbersome for people to request this information. To deal with privacy concerns when requesting a report, consumers could verify their identities by using a credit card, as other applicants do, but then not have the card billed.

- **Require creditors to identify any offer of credit at less than the most favorable terms as an "adverse offer,"** as has been called for by the Federal Trade Commission. This would include pre-screened "subprime" mortgage offers or credit cards solicitations that are based on negative or less than favorable credit information. As is well known, the subprime credit industry has boomed in the past decade by offering borrowers with blemished or limited credit histories mortgage loans, car loans and credit cards at higher rates and less favorable terms than offered to their "prime" borrowers. As lenders increasingly offer a continuum of loans at different rates and terms, it is more important than ever that consumers have the ability to exercise their FCRA rights to insure that adverse credit information is correct. In the world of "risk-based" pricing, borrowers should know that they are being targeted because of their less than optimal credit history and should be offered the opportunity to check their credit history and change any information that is not accurate or complete. Furthermore, as stated above, many consumers are unwittingly giving up their FCRA rights because they are accepting loans that are legally considered "counteroffers."

- **Consumers should also be able to obtain directly from the <u>lender</u> a free copy of the "subscriber" report and score used to deny credit or offer it under less favorable terms.** This report includes the actual report data by the lender used to take an adverse credit action. Employment applicants already have a similar right under FCRA but borrowers currently do not. Easy access to this information will also provide a powerful incentive for credit bureaus to improve accuracy, as well as giving consumers a helpful educational tool. Consumers face two problems when they request a credit report (and score) from a credit bureau. First, any adverse actions previously taken were based on a subscriber credit report provided to the lender. The subscriber report is often provided based on a limited number of matching data points and is more likely to contain inaccurate or mis-merged information about other consumers than a report requested by a consumer, since a consumer must provide a detailed match of name, address, and Social Security Number. Second, a score derived from that consumer report will probably differ from the score the subscriber obtained from the less accurate report. Upon receiving the subscriber report, consumers would then be allowed to identify any errors or out-of-date information, provide documentation, and be reevaluated for the loan or for prime rates. The additional cost to lenders and businesses of providing these reports immediately would be minimal. Since they already posses the report in paper or electronic form, they would merely have to copy or print this report.

- **Provide consumers with <u>detailed</u> explanations as to why credit is denied or less-than-favorable terms are offered**. In its study of credit score accuracy[4], CFA found that approximately seven in ten credit reports indicated that the primary factor contributing to the credit score was "serious delinquency," "derogatory public record," "collection filed," or some combination of these factors. This generic and extremely vague information provided by creditors when they take an adverse credit action is too general to be helpful, especially for most subprime borrowers, who by definition have some credit blemishes. Instead, lenders should be required to identify any specific entries (trade lines) that are lowering a consumer's score and indicate the impact on the consumer (either the point value deducted for that entry or the proportional impact relative to other derogatory entries.)

- **Require creditors and other data furnishers to notify consumers any time derogatory information has been placed on a credit report**. The state of Colorado requires credit bureaus to provide consumers who have had any negative information added to their reports with annual notification of their rights. This would offer consumers the opportunity to check the accuracy of this information when it is submitted, as opposed to finding out the next time the consumer applies for credit and is turned down or offered a high interest rate.

**Second, allow consumers to quickly and easily question the accuracy and completeness of information in credit reports.**

- **Give consumers an FCRA right to contact a furnisher directly to initiate reinvestigation**, as the Federal Trade Commission has recommended. As stated above furnishers have no legal obligation under current law to investigate a credit reporting error, if contacted by the consumer. Under the FCRA, credit furnishers only have a legal obligation to respond to a reinvestigation begun by a credit bureau, at the request of a consumer. As a result, consumers often face longer delays and more "finger pointing" when they contact their lender about a credit reporting problem first. The law should make it clear that furnishers have an obligation to respond to their customers if a credit reporting complaint is made.

- **Shorten the deadlines by which creditors must respond to consumer disputes about credit information.** Currently, the FCRA provides creditors with 30 days to respond to a dispute; 45 days if the consumer submits additional documentation about the dispute. In the age of "instant credit" and three-day credit re-scoring by credit reporting resellers, these deadlines are much too long. By the time the consumer hears back from the credit bureau about the outcome of the dispute, he or she might have lost a home loan (and the home) or submitted to a loan at a higher rate than he or she was entitled to. Given how fast credit decisions are now made, resolution deadlines of ten days (fifteen if the consumer submits additional information) do not seem unreasonable. Credit bureaus

[4] Consumer Federation of America and National Credit Reporting Association. *Credit Score Accuracy and Implications for Consumers*. December 2002. Available at: http://www.consumerfed.org/121702CFA_NCRA_Credit_Score_Report_Final.pdf

have shown in recent years that extremely quick reinvestigations are possible. The credit bureaus have a well-documented system that provides "concierge" services for certain classes of consumers. VIPs and consumers who are suing the bureaus generally can get complaints resolved more quickly. The most efficient reinvestigation systems are provided for consumers working with certain mortgage entities, where rapid re-scoring can gain a correction in 24-48 hours.

- **Require the FTC and other regulators to fully enforce the existing requirement that credit bureaus consider all information relevant to a consumer's dispute**, including information provided by the consumer, and to require bureaus to reject findings of so-called furnisher reinvestigation that conflict with such relevant information provided by the consumer. This Committee has already heard testimony, from Evan Hendricks and others, that credit bureaus and furnishers are failing to conduct reinvestigations in a reasonable manner.

**Third, give consumers better private enforcement rights**, since the agencies aren't adequately enforcing the accuracy provisions of the law:

- **Give consumers the right to go to a court and seek injunctive relief** to stop a credit bureau from selling faulty credit reports about them.

- **Give consumers the right to seek minimum statutory damages of $100 to $1,000 per violation of the FCRA, as other consumer laws provide**, so that they don't have to prove their actual damages to a court. This provision is especially critical for identity theft victims, who often spend hundreds of hours over a period of years trying to clear their good names. While the cost of emotional distress is significantly greater than $100 to $1000, the threat of specific damages would be a powerful incentive to force creditors and credit bureaus to clean up the credit reporting system's accuracy.

## Improving Overall Financial Literacy

The results of this survey also point to the need for a long-term strategy to boost general financial awareness and to improve financial decision-making by Americans. There has never been a greater need to advance financial education.

The financial education needs of the least affluent and well-educated Americans are especially pressing, in part because recent changes in the financial services marketplace have increased the vulnerability of these households. In particular, the dramatic expansion of high-cost and sometimes predatory lending to moderate and lower income Americans in the last decade has put many of these people at great financial risk. Because these individuals lack financial resources and often are charged high prices, they cannot afford to make poor financial choices. But because of low general and financial literacy levels, they often have difficulty making smart financial decisions, in part because they are especially vulnerable to abusive seller practices.

There is no large population that would benefit more from improved financial education than the tens of millions of the least affluent and well-educated Americans. In 1998, 37 percent of all households had incomes under $25,000. With the exception of older persons who had paid off home mortgages, these households had accumulated few assets. In 1998, according to the Federal Reserve Board's Survey of Consumer Finances, most of these least affluent households had net financial assets (excluding home equity) of less than $1,000. Moreover, between 1995 and 1998, a time of rising household incomes, the net worth of lower-income households actually declined.

For lower income households with few discretionary financial resources, failing to adequately budget expenditures may pressure these consumers into taking out expensive credit card or payday loans. Mistakenly purchasing a predatory mortgage loan could cost them most of their economic assets.

These households also need to make smart buying decisions because they tend to be charged higher prices than more affluent families: higher homeowner and auto insurance rates because they live in riskier neighborhoods; higher loan rates because of their low and often unstable incomes; higher furniture and appliance prices from neighborhood merchants that lack economies of scale and face relatively high costs of doing business; and higher food prices in their many neighborhoods without stores from major supermarket chains. Lower-income families are also faced with higher prices for basic banking services and they lack access to essential savings options.

Lower-income households with low literacy levels are especially vulnerable to seller abuse. Consumers who do not understand percentages may well find it impossible to understand the costs of mortgage, home equity, installment, credit card, payday, and other high-cost loans. Individuals who do not read well may find it difficult to check whether the oral promises of salespersons were written into contracts. And, those who do not write fluently are limited in their ability to resolve problems by writing to merchants or complaint agencies. Consumers who do not speak, read, or write English well face special challenges obtaining good value in their purchases.

Over the past decade, the financial vulnerability of low- and moderate-income households has increased simply because of the dramatic expansion of the availability of credit. The loans that subjected the greatest number of Americans to financial risk were made with credit cards. From 1990 to 2000, fueled by billions of mail solicitations annually and low minimum monthly payments of 2-3 percent, credit card debt outstanding more than tripled from about $200 billion to more than $600 billion. Just as significantly, the credit lines made available just to bankcard holders rose to well over $2 trillion. By the middle of the decade, having saturated upper- and middle-class markets, issuers began marketing to lower-income households. By the end of the decade, an estimated 80 percent of all households carried at least one credit card. Independent experts agree that expanding credit card debt has been the principal reason for rising consumer bankruptcies.

Also worrisome has been the expansion of high-priced mortgage loans and stratospherically-priced smaller consumer loans. In the 1990s, creditors began to aggressively market subprime mortgage loans carrying interest rates greater than 10 percent and higher fees than those charged on conventional mortgage loans. By 1999, the volume of subprime mortgage loans peaked at $160 billion. Mortgage borrowers in low-income neighborhoods were three times more likely to have subprime loans than mortgage borrowers in high-income neighborhoods. A significant minority of these subprime borrowers would have qualified for much less expensive conventional mortgage loans. Some of these borrowers were victimized by exorbitantly priced and frequently refinanced predatory loans that "stripped equity" from the homes of many lower-income households.

The 1990s also saw explosive growth in predatory small loans -- payday loans, car title pawn, rent-to-own, and refund anticipation loans -- typically carrying effective interest rates in triple digits. The Fannie Mae Foundation estimates that these "loans" annually involve 280 million transactions worth $78 billion and carrying $5.5 billion in fees. The typical purchaser of these financial products has income in the $20,000 to $30,000 range with a disproportionate number being women.

Both proper regulation and education are necessary to insure that lower and moderate income Americans are not subject to abusive lending practices and that they have the knowledge to make effective decisions in an increasingly complex financial services marketplace.

Thankfully, Senators Sarbanes, Shelby, Stabenow, Enzi and Akaka have all shown a great deal of interest in improving financial education efforts in this country. For example, Senator Sarbanes' recently proposed an idea that has a lot of merit: creating a Financial Literacy and Education and Coordinating Committee within the Department of the Treasury.

While many worthwhile financial education programs exist, they are not well-coordinated, effectively reach only a small minority of the population, and do not reflect any broad, compelling vision. Many focus only on increasing consumer knowledge of how to best operate in the financial services marketplace, and not on actually changing consumer behavior to improve decisions about spending, saving, and the use of credit. Moreover, there is no clear consensus about how to effectively provide financial education, especially to those who have completed their secondary education and to those with low literacy levels. What is most needed is a comprehensive needs assessment and plan to guide and inspire financial educators and their supporters. Moreover, for any comprehensive plan to win broad public and private support and participation, the federal government must provide leadership. Both a comprehensive strategy and federal leadership (not ownership) are called for in the Sarbanes' bill. Such an approach could also convince a broad array of government, business and nonprofit groups to work together to persuade the nation to implement that plan.

We commend Senator Sarbanes for proposing a comprehensive and achievable vision for improving financial awareness and decision-making. We look forward to working with him, Senator Shelby and the other Senators I mentioned to improve financial education in this country.

**<u>Conclusion</u>**

I applaud the Chairman, the Ranking Member and all the members of this committee for the exhaustive and informative set of hearings that you have conducted about the state of the Fair Credit Reporting Act. As the Committee begins writing legislation to deal with the problems that have been identified in these hearings, I urge you not to overlook what we heard from Americans in our survey. Consumers want a credit reporting system that is more accurate, more transparent and that better protects their privacy. I look forward to working with the Committee to achieve these important goals.