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Statement of

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Mr. Chairman and members of the Committee, I appreciate the opportunity to testify on the significance of maintaining a reliable national credit reporting system, the importance of the Fair Credit Reporting Act to that system, and the need for consumer awareness of how this system functions and relates to their ability to obtain credit.

I. Background and Overview of the Fair Credit Reporting Act

A. Background

In the past, local banking institutions knew the credit capacity of individuals in their community. As the financial services industry has grown larger, financial products and services more complex, and the U.S. population more mobile, it is no longer feasible for institutions to evaluate the credit standing of consumers based solely on their direct experiences with such consumers. Centralized credit bureaus, or consumer reporting agencies, have evolved to provide a repository of credit history information that can be accessed by creditors to evaluate the creditworthiness of prospective borrowers. This national credit reporting system provides creditors with an efficient, competitive, and cost-effective method of obtaining data for credit decision-making and consumers with increased credit availability.

The data on what consumers understand about the credit granting process, and how their credit report relates to that process, are limited. There is some anecdotal evidence that consumers are generally aware of the terms "credit scoring" and "credit rating," but that they are not clear on how credit scores are used in credit granting. Because information obtained through the national credit reporting system has become invaluable to creditors in determining the creditworthiness of consumers, it is crucial that consumers understand how this system operates and impacts their ability to obtain credit and the pricing of credit. Educated consumers who make informed decisions about credit are essential to an efficient and effective marketplace.

Consumers who understand how their credit-risk profile relates to credit rates and terms can better determine which credit product suits their needs.

Today, each of the three national consumer reporting agencies--Experian, Equifax, and Trans Union--maintains records on as many as 1.5 billion credit accounts held by approximately 190 million individuals. Each of the consumer reporting agencies receives more than 2 billion items of information per month and issues roughly 2 million credit reports each day.[1]

The information gathered by the consumer reporting agencies is obtained from banks, savings associations, credit unions, finance companies, retailers, other creditors, and collection agencies, as well as from public records. A consumer report generally consists of five types of information: identifying information, such as the consumer's name and address; detailed information reported by creditors regarding individual credit accounts; public record information, such as records of bankruptcies, foreclosures, and tax liens; information reported by collection agencies, mostly regarding non-payment of bills; and information regarding inquiries about a consumer's credit record. Consumer reports are used for credit, insurance, employment, and certain other limited purposes.

B. Overview of the Fair Credit Reporting Act

The Congress adopted the Fair Credit Reporting Act (FCRA) in 1970 to regulate credit reporting systems in the United States, and passed significant amendments in 1996. The primary purposes of the FCRA are to ensure fair and accurate credit reporting and to protect consumers' privacy. Among other things, the FCRA imposes certain obligations on consumer reporting agencies, on users of consumer reports, and, since 1996, on furnishers of information.

[1] See "An Overview of Consumer Data and Credit Reporting," Federal Reserve Bulletin, February 2003, at 49-50.

A person may obtain a consumer report only for a permissible purpose. The FCRA specifies the permissible purposes, which include using the information contained therein for a transaction involving an extension of credit to a consumer. If a creditor takes any action that is adverse to a consumer based on information in a consumer report, the creditor generally must give the consumer a notice of the adverse action. This notice informs consumers about their rights under the FCRA.

Participation in the U.S. credit reporting system is voluntary. Creditors are not required to obtain consumer reports before making credit decisions, although most creditors rely on consumer reports for risk-management purposes. Creditors also are not required to furnish information to consumer reporting agencies. But if they do, the information they furnish must be accurate. They must correct and update erroneous information, and must investigate any disputed information.

Consumer reporting agencies have extensive responsibilities under the FCRA. Those responsibilities include: maintaining reasonable procedures to ensure that consumer reports are furnished only to persons having a permissible purpose; following reasonable procedures to ensure the maximum possible accuracy of consumer reports; reinvestigating the accuracy or completeness of any disputed information and notifying the consumer of the results of the reinvestigation; omitting certain obsolete information from consumer reports after specified periods of time; and providing consumers with a copy of their consumer reports upon request.

The FCRA contains important consumer rights and protections. Several are designed to promote accuracy in consumer reports. For example, the right to receive notice if information in a consumer report has resulted in adverse action enables consumers to check the accuracy of information in their credit reports. An adverse action notice must inform the consumer of the name, address, and telephone number of the consumer reporting agency that furnished the report, the consumer's right to obtain a free copy of the consumer report, and the consumer's right to dispute the accuracy or completeness of any information in the consumer report. Consumers have a right to obtain a copy of their consumer reports, upon request; currently this right does not extend to getting their credit score.[2] Consumers also have the right to dispute the accuracy or completeness of any information in their consumer reports with a consumer reporting agency, to have such information deleted or corrected, and to have a statement of dispute included in the report if the dispute is not resolved. Consumers may also dispute the accuracy of items with the furnisher of the information.

Other consumer rights and protections are designed to protect consumer privacy. Consumers have a right to be excluded from prescreened solicitation lists. The three national consumer reporting agencies maintain a toll-free telephone number that consumers can call to exercise this right. Limiting access to consumer reports to persons that have certified a permissible purpose under the FCRA also protects consumer privacy. In general, the FCRA restricts the sharing of certain information among affiliates unless the consumer is given the opportunity to opt out of that sharing. Additional privacy protections apply in circumstances where consumer reports are provided to prospective employers or contain medical information, and where investigative consumer reports are prepared or obtained.

II. The Importance of the National Credit Reporting System

Maintaining a reliable national credit reporting system is essential to ensure the continued availability of consumer credit at reasonable cost. As Chairman Greenspan has observed, "unless we have some major sophisticated system of credit evaluation continuously updated, we

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[2] A credit score is a numerical representation of a consumer's overall credit profile arising from mathematical procedures that weight attributes in the way that best distinguishes between preferred and not preferred accounts.

will have very great difficulty in maintaining the level of consumer credit currently available[.]"[3] Without the information that comes from various credit bureaus and other sources, lenders would have to impose higher costs on consumers to compensate for the increased risk and uncertainty associated with the credit they extend.

The ready availability of accurate, up-to-date credit information from consumer reporting agencies benefits both creditors and consumers. Information from consumer reports gives creditors the ability to make credit decisions quickly and in a fair, safe and sound, and cost-effective manner. Consumers benefit from access to credit from different sources, the competition among creditors, quick decisions on credit applications, and reasonable costs for credit.

A. The Importance of Credit Scoring

Credit scoring has become an important tool in the credit granting process. Credit scoring models, which typically are proprietary to individual institutions or consumer reporting agencies, use credit bureau information and other data to construct mathematical scorecards that can accurately predict levels of creditworthiness across various populations. These models assign positive and negative weights to items of information that have demonstrated statistical usefulness for the evaluation of credit risk. Credit scoring enables creditors to evaluate, quickly and inexpensively, the risk of lending to credit applicants, and promotes the making of expedited credit decisions in a safe and sound manner. Consumers benefit from the increased availability and lower cost of credit made possible by the use of credit scoring models. Credit scoring also may help to reduce unlawful discrimination in lending to the extent that these systems are designed to evaluate all applicants objectively and thus avoid issues of disparate treatment.

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[3] Remarks following prepared testimony by Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, April 30, 2003, House Financial Services Committee.

As Chairman Greenspan has noted, the emergence of credit scoring technologies "has proven useful in expanding access to credit for us all, including for lower-income populations and others who have traditionally had difficulty obtaining credit. It has also enabled financial institutions to offer a wide variety of customized insurance, credit and other products."[4] Chairman Greenspan has stressed the importance of maintaining a system that provides incentives to develop more sophisticated credit scoring models and enables credit scoring models and technologies to advance.[5]

B. Risk-Based Credit Pricing

Credit evaluation systems rely on information gathered by consumer reporting agencies on consumers' borrowing and payment experiences to measure the credit risk posed by current and prospective borrowers. Risk-based pricing, which has become increasingly common in all sectors of the credit industry, is a mechanism by which the rates offered or charged to consumers reflect the creditworthiness and risk posed. Risk-based pricing is made possible because creditors have available to them data from consumer reports, including credit scores, which permit them to assess the risk profiles of individual consumers. For example, a consumer demonstrated to have an extremely low risk of default or delinquency, based on a consumer report, would likely be offered a very favorable interest rate; a consumer with a marginal credit history, on the other hand, may also be offered credit, but at a higher rate. Risk-based pricing permits creditors to offer credit products tailored to the consumer's individual risk profile.

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[4] Letter from Chairman Alan Greenspan to Congressman Rubén Hinojosa, February 28, 2003.
[5] Remarks following prepared testimony by Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, July 15, 2003, House Financial Services Committee.

III. The Importance of the FCRA to the National Credit Reporting System

A. Federal Preemption under the FCRA of Certain State Laws

In 1996, the Congress amended the FCRA and, among other things, preempted the states from enacting laws or regulations dealing with seven areas addressed by the FCRA. These seven areas include: the procedures for using prescreened solicitations; the time for reinvestigating disputed information; the duties of creditors that take adverse action; the informational contents of consumer reports; the duties of furnishers of information; affiliate information sharing; and the form and content of the summary of rights disclosure. Through these preemption provisions, the Congress effectively established uniform national standards in these areas. The FCRA preemption provisions are scheduled to sunset on January 1, 2004. After that date, states would be permitted to enact laws in these seven areas if those laws explicitly provide that they are intended to supplement the FCRA and give greater protection to consumers than is provided under the FCRA.

Chairman Greenspan has stated his support for making permanent the provision currently in the FCRA to provide for uniform federal rules. In an appearance before the House Financial Services Committee earlier this year, Chairman Greenspan spoke of the importance of having "national standards" under the FCRA, and cautioned that with significant differences state by state, it would be very difficult to maintain as viable a system as we currently have.

The FCRA promotes the national credit system in important ways. Perhaps most significantly, the availability of standardized consumer reports--that contain nationally uniform data--allows banks to make prudent credit decisions efficiently wherever they do business and wherever their customers live and work. The FCRA's national standards governing furnisher responsibilities and duties of users taking adverse action--the two primary areas of responsibility for most financial institutions--promote efficiency by enabling banks to comply with a single set of rules for all of their domestic credit operations. State-specific restrictions on furnishing information to consumer reporting agencies, or on the contents of information contained in consumer reports supplied by consumer reporting agencies, could negatively affect credit availability and increase the cost of credit.

B. Accuracy of Consumer Reports

Although maintaining uniform federal rules in the seven areas where the FCRA currently preempts state action is essential to the national credit system, the current system is by no means perfect. In particular, concerns have been raised about the accuracy and completeness of information in consumer reports. Recent studies have shown that consumer reports sometimes contain inaccurate, incomplete, or inconsistent data, although the degree to which this is a problem is in dispute.[6] Moreover, the growing problem of identity theft only heightens concerns about the accuracy of consumer reports, because of the difficulties that victims often face in having fraudulent accounts removed from their credit files.

The accuracy of consumer report information is a critical element of the national credit reporting system. Most of the problems associated with consumer reporting agency data appear to result from the failure of creditors, collection agencies, or public entities to furnish complete and consistent information in a timely manner.[7] Four particular areas of concern with regard to consumer report accuracy include: (1) the failure to report credit limits; (2) the failure to report updated information on accounts; (3) the failure to report non-derogatory accounts or minor delinquencies; and (4) the inconsistent reporting of public record data, collection agency data,

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[6] For a summary of these recent studies, see "An Overview of Consumer Data and Credit Reporting," Federal Reserve Bulletin, February 2003, at 50.
[7] Id. at 70-73.

and inquiries.[8] Although the financial services industry has undertaken efforts to address the problem of inaccurate (and incomplete) information in order to deter fraud, ongoing efforts are needed to ensure that information furnished to consumer reporting agencies is accurate, timely, and complete. Concerns about the accuracy of consumer reports can be alleviated to some extent through consumer education, such as efforts to encourage consumers to check their consumer reports periodically.

C. Adverse Action Notices and Risk-Based Credit Pricing

Under the FCRA, if a creditor denies credit or takes other "adverse action" based on information in a consumer report, the creditor generally must give the consumer a notice of that fact. Among other things, the notice must also tell consumers of their right to obtain a free copy of their credit report and to dispute inaccurate information. The FCRA incorporates the definition of "adverse action" contained in the Equal Credit Opportunity Act and its implementing regulation, the Federal Reserve Board's Regulation B. Under the ECOA and Regulation B, consumers are entitled to a notice containing the specific reasons for a credit denial or other adverse action. The FCRA and ECOA notices, which are typically combined, provide an important tool in educating consumers about the impact on credit availability of negative information in their consumer reports. Receiving notice of the specific reasons for adverse action coupled with notice that the adverse action was based in whole or in part on information in a consumer report (1) alerts consumers to specific problems or possible inaccuracies in their credit reports, and (2) informs consumers of their right to obtain a free copy of the report and to dispute inaccurate information.

With the increase in risk-based pricing, consumers who previously would have been denied credit (and would have received adverse action notices) now are offered credit at rates

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[8] Id. at 71-72.

that reflect their risk as borrowers, thus expanding access to credit. When a consumer accepts a creditor's offer of credit, even on different terms from those that were requested, an adverse action notice is not required under Regulation B, and hence is not required under the FCRA. Therefore, when consumers apply for credit, adverse action notices are given to them less frequently than in the past.

Concern has been raised that because of risk-based pricing, adverse action notices may no longer be meeting at least part of the intended purpose under the FCRA--helping to ensure the accuracy of consumer reports. Inaccurate information in a consumer report may negatively impact access to credit at rates that reflect the consumer's creditworthiness, but there is no adverse action notice directing the consumer's attention to potential errors that may stand in the way of more favorable terms.

One suggested approach for addressing this concern is to revise the FCRA definition of adverse action to require that creditors provide an adverse action notice whenever credit is granted on material terms less favorable than those otherwise available. For example, a creditor using a risk-based pricing system may offer a credit card based on an assessment of the consumer's creditworthiness with rates ranging from 7.99 to 14.99 percent. A consumer would receive an adverse action notice if the consumer was offered and accepted a rate of 8.99, rather than the lowest rate of 7.99 percent, based on that risk assessment. Providing adverse action notices to consumers that receive credit might provide some benefit to consumers, but at a cost to industry that likely would outweigh the potential benefit.

Other tools could be made available to consumers to mitigate these concerns. For example, the Congress is now considering legislation to give consumers the right annually to obtain a free copy of their consumer reports upon request. If enacted, such legislation could encourage consumers to check their consumer reports periodically, particularly if coupled with appropriate consumer education about the importance of consumer reports and how to check for accuracy.

IV. Consumer Education and Financial Literacy

Consumer education and financial literacy play an important role in helping consumers to understand the credit system and their own credit standing.[9] Financial education can equip consumers with the knowledge required to make better choices among the financial products and services, thus enabling consumers to obtain those products and services at the lowest cost available to them. Financial education is particularly valuable for populations that have traditionally been underserved by the financial system and may help protect vulnerable consumers from abusive credit arrangements that can be financially devastating.

Markets operate more efficiently when consumers are well informed. Making informed decisions about what to do with their money will help build a more stable financial future for individuals and their families. The Federal Reserve System recently launched a national financial education initiative to encourage consumers to learn more about personal financial management, complete with a public service announcement that featured Chairman Greenspan. The objective of this initiative is to highlight the benefits of financial education and to provide information on the resources available to consumers for assistance in managing their finances. The Federal Reserve's financial education web site (www.FederalReserveEducation.org) makes available a variety of materials that may be useful to consumers, including a brochure entitled

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[9] The Federal Reserve, however, does not have data that measure consumers' level of knowledge or awareness of credit reporting, credit scoring, or how the credit system operates. We do conduct consumer research but the focus generally targets consumer knowledge of specific practices or products.

"There's a Lot to Learn about Money" that contains tips for managing credit wisely and protecting personal credit ratings.

In addition, the Federal Reserve Bank of Boston has published an excellent educational video and booklet on identity theft that explains what identity theft is, how consumers can protect themselves from becoming victims, and what they should do if they do become victims. These materials also explain the importance of checking consumer reports regularly, provide tips for how to read a consumer report, and list appropriate contact information for the three major consumer reporting agencies and certain federal government agencies. A copy of the Boston Reserve Bank's identity theft booklet can be viewed online at the Federal Reserve Bank of Boston's public web site (www.bos.frb.org/consumer/identity/index.htm).

V. Conclusion

The Committee is to be commended for undertaking an examination of the FCRA and related issues at this important juncture. In conducting this examination, it is important to maintain a viable, national credit-reporting system that preserves and expands reasonable access to credit, and to promote consumer understanding and awareness of the credit-reporting system and how it relates to the credit-granting process.