A WRITTEN STATEMENT OF FAIR ISAAC CORPORATION

ON CONSUMER UNDERSTANDING AND AWARENESS OF THE CREDIT GRANTING PROCESS

BEFORE THE UNITED STATES SENATE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

WASHINGTON, D.C.

JULY 29, 2003

**Introduction.** Mr. Chairman and members of the committee, my name is Cheri St. John. I am the Vice President of Global Scoring Solutions for Fair Isaac Corporation. Thank you for the opportunity to testify before you today about Fair Isaac's leadership in improving the financial literacy of American consumers, specifically with respect to Fair Isaac's efforts to empower consumers by providing them with actionable information about the credit scores that lenders use to make credit decisions.

**Fair Isaac Corporation.** Fair Isaac Corporation is the preeminent provider of creative analytics that unlock value for people, businesses and industries. Founded in 1956, Fair Isaac helps thousands of companies in over sixty countries acquire customers more efficiently, increase customer value, reduce fraud and credit losses, lower operating expenses, and make more credit available to more people. Fair Isaac pioneered the development of statistically-based credit risk evaluation systems, commonly called "credit scoring systems," and is the world's leading developer of those systems. Thousands of credit grantors use broad based credit scores commonly known as "FICO® scores" generated by Fair Isaac-developed scoring systems implemented at the national credit reporting agencies. Fair Isaac has also developed custom scoring systems for hundreds of the nation's leading banks, credit card issuers, finance companies, retailers, insurance companies, and telecommunication providers.

There are many different kinds of credit scores. The most well known are the broad based credit risk scores developed by Fair Isaac know as FICO scores and widely distributed to lenders by the three national credit bureaus under the brand names: Beacon from Equifax; Empirica from Trans Union; and, the Experian/Fair Isaac Risk Model from Experian. Indeed, there are several versions of the above FICO scores available because some lenders adopt newly developed versions more quickly than other lenders. There are also broad based credit scores developed by each of the three bureaus and from other third party developers. There are custom models developed for use by individual lenders. There are also credit score models developed for specific industries, such as the mortgage, automobile and telecommunications industries. Finally, there are credit scores distributed primarily to the consumer market.

Over the last forty years credit scoring has become an important part of most credit decisions, such that Fair Isaac believes some form of credit scoring is now used in the majority of consumer credit decisions. A FICO Score is a 3-digit number that tells lenders how likely a borrower is to repay as agreed. To develop the models that generate the credit scores, Fair Isaac analyzes anonymous credit report data to statistically determine what factors are most predictive of future credit performance. Factors that do not have predictive value and factors that by law cannot be used in the credit decision are excluded from consideration. FICO scores use information from consumer credit reports to provide a snapshot of credit risk at a particular point in time. Scores can change over time, as subsequent credit risk predictions reflect changes in underlying behaviors.

Fair Isaac is a leading developer of insurance risk scores. Over 350 insurance companies use Fair Isaac insurance scores that they obtain through national credit reporting agencies. Although insurance scores utilize credit data, they differ from credit scores in that insurance scores are developed based on insurance premium and loss history and predict future insurance loss ratio relativity. Like credit scores, insurance scores do not consider a person's income, marital status, gender, ethnic group, religion, nationality or neighborhood, and the scores are applied consistently from one consumer to the next. A strong statistical correlation has been repeatedly demonstrated between credit data and insurance loss ratio[1], and insurance scores have become a valuable component in determining insurability and the rate assigned. Insurers use insurance scores to accelerate their processing for applicants and renewal shareholders, to concentrate additional underwriting attention on higher-risk individuals, and to better manage operational strategies. Consumers benefit from lower rates. Insurers have stated that 60-75% of their policy

[1] See, *Predictiveness of Credit History for Insurance Loss Ratio Relativities*, October 1999; Attachment 1: *A Statistical Analysis of the Relationship Between Credit History and Insurance Losses,* Bureau of Business Research (McCombs School of Business) at the University of Texas, March, 2003 available at http://www.utexas.edu/depts/bbr/bbr_creditstudy.pdf.

holders pay lower premiums because of insurance scoring. Fair Isaac has been supportive of the efforts of insurance score users to educate consumers and agents about insurance scoring.[2]

**With credit scoring, more people get credit, they get it faster, and it's more affordable.** FICO scores mean more people have access to credit. Credit scores allow lenders to better assess their risk and tailor credit for each consumer's needs. FICO scores are used in almost every sector of the nation's economy: for mortgages, credit cards, auto loans, personal loans, even cell phone service. More people can get credit regardless of their credit history because credit scores allow lenders to safely assess and account for the risk of consumers who have no existing relationship with the lender, who have never entered the lender's branches, and who may have been turned away in the past by other lenders. Lenders use scores not only to evaluate applications, but also to manage the credit needs of existing customers by extending additional credit or helping consumers avoid overextending themselves. FICO scores are also used by lenders and securities firms as to aid securitization of credit portfolios which provides lenders the capital they need to make credit available to more consumers. FICO scores are accepted, reliable[3], and trusted to the point that even regulators including federal bank examiners, and security rating agencies, use them to help ensure the safety and soundness of the financial system.[4]

FICO scores mean people get credit faster. "Instant credit" at a retailer, an auto dealer, over the phone, or on the Internet would not be possible without credit scores. Even mortgage loans that used to take weeks can now be done in minutes. Among the tremendous lending advances in the U.S. over the last decade has been the streamlining of the lending process, so that credit approvals – not just on credit cards but on installment loans, mortgages, home equity lines of credit and even commercial loans to small businesses – can be made faster with less manual

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[2] See e.g., *Answers to Your Questions About Insurance Bureau Scores*, Attachment 2.
[3] See Attachment 3, *A Clarification of the Consumer Federation of America's Observations About Credit Score Accuracy*.
[4] See Attachment 4 for examples of Federal agencies that use FICO scores.

review, less paperwork and fewer data requests. All of this has occurred while lenders have not only preserved but strengthened their visibility and control over their risk exposure.

FICO scores mean people pay less for their credit. Scores make credit more affordable by reducing the cost of evaluating applications, reducing loan losses, reducing the cost of managing credit portfolios, reducing marketing costs with prescreening, and cutting the cost of capital with securitization. This efficient flow of credit and capital has a large part to play in the continued robustness of the American economy. By enabling lenders to extend credit quickly while managing their risk, credit reports and credit scores have made credit more accessible, at lower rates, to more people.

Lenders must make a credit decision, and they must predict the future in doing so. Lenders can use a variety of decision making techniques to predict the future, ranging from a simple subjective evaluation of application and credit history information by a loan officer, to predictive technologies, including credit scoring. When a creditor switches from judgmental decisions to scoring, it is common to see a 20-30% increase in the number of applicants accepted with no increase in the loss rate. Lenders should use all the information that is legally, economically and efficiently available to make the best and fairest possible decision for each individual with whom they do business. FICO scores, when used properly, make a tremendous contribution in doing just that. FICO scores use only legal data as inputs, and only those factors proven to be predictive of credit risk. Scores are also more consistent from consumer to consumer because they assess the same factors the same way, each time.

Studies have concluded that the same Fair Isaac credit score indicates the same level of risk regardless of the income level of the consumer or whether the consumer resides in an area with a high percentage of minority residents, with differences consistently favoring the low to moderate income ("LMI") and high minority area ("HMA") applicants.[5] Those same studies indicate that credit scoring is a far more predictive screen for both the LMI and HMA applicants than is judgmental decision making. Finally, the multiple scorecard systems developed by Fair Isaac and resident at the three main U.S. credit bureaus were proven to be more predictive than a single scorecard developed for the HMA population for the study.

Fair Isaac credit scores transform the economics and efficiency of the credit decision to allow all relevant information to be brought to bear so that no information that is favorable to an individual is omitted from the decision process. Credit scoring scientifically, and therefore fairly, balances and weighs *positive* information along with any negative information in credit reports. In essence, full positive credit reporting and scoring have "democratized" credit granting – information about all consumers is available to all lenders for a fair evaluation. Scoring has transformed credit granting so that it is no longer simply based on who you know.

**Financial Education and Consumer Empowerment Depend Upon Actionable Information About the Credit Scores That Lenders Use**

**Fair Isaac Supports Consumer Education and Empowerment**.

When lenders first began using credit scoring , Fair Isaac provided both lenders and regulators the information and training needed for effective score tracking and oversight. Lenders have always been provided with the top four reasons with every credit score, in order of their importance to the score. As credit scoring use has grown, Fair Isaac has responded by providing consumers with the information they need to understand credit scoring and use it to take control of their credit health. Fair Isaac has published consumer booklets on credit scoring since the early 90's on its own and in conjunction with others such as the FTC. Free Information has also been available to consumers at www.myFICO.com, since its inception. Consumers interested in learning more about their individual score can access www.myFICO.com to get their own FICO

[5] See, *The Effectiveness of Scoring on Low-to-Moderate Income and High Minority Area Populations*, a Fair Isaac Paper dated August, 1997, Attachment 5.

Score, accompanied by the underlying credit report, and a complete explanation of their personal FICO score for $12.95. Fair Isaac has given consumers a place in the credit reporting process by pioneering consumer credit empowerment with its myFICO.com score explanation. Millions of consumers have already taken steps to control their credit lives by using myFICO to obtain informative, actionable credit-information services including the FICO scores that lenders use, and to help improve and protect their overall financial health.

Explanations of Adverse Action. Consumers, by law, are provided with the key reasons behind their score, when those score(s) were a factor in a decision resulting in an adverse action. These reason codes provided with the FICO score can be used by the lender as part of its explanation to the consumer of any adverse action taken and what the consumer can do to improve their outlook for being approved for credit in the future.

Evolution of Consumer Credit Score Education. FICO scores first became available commercially from all three national credit reporting agencies in 1991. Prior to the mortgage industry's embrace of credit risk scoring technology in the mid-1990s, U.S. consumers generally were not aware of this business decision tool and it was not as widely used. This started to change in 1995 when Fannie Mae and Freddie Mac approved the use of credit risk scoring by mortgage lenders. Their approval prompted an increasing number of mortgage lenders and mortgage brokers to use credit risk scores in loan underwriting. Other industries began relying more heavily on FICO scores as well, such as auto lenders and bankcard issuers. Through consumers' interaction with brokers and lenders, the public became more aware of credit scores. The news media also began reporting on this as yet relatively unknown lender risk evaluation tool.

Five years ago, market research showed an initiative to educate consumers about credit scoring was likely to fail due to lack of consumer interest. Once the wide use of credit scores made consumers receptive, however, Fair Isaac launched its consumer education initiative that has made it a leader in promoting financial literacy for all consumers.

We believe it is instructive to briefly review the development of consumer credit education to show how Fair Isaac continues to respond to the need for financial literacy as consumers' awareness grows. The one constant has been Fair Isaac's commitment to the disclosure of credit scores in a way that equips the consumer with accurate, actionable information while avoiding the confusion that can be created from a misunderstanding of a complex topic.

***Initiative to Demystify FICO Scores.*** On June 8, 2000, Fair Isaac announced its public disclosure of all the factors used in its FICO credit bureau risk scores. The list was made publicly available on the company's Web site for free, and remains free and accessible today at http://www.myfico.com/myfico/CreditCentral/ScoreConsiders.asp.

***FICO Guide*.** By late October, 2000 Fair Isaac had developed and launched an online service called FICO Guide. FICO Guide provided a FICO score explanation when a lender or broker provided the consumer with his or her FICO score, the accompanying reason codes, and the name of the credit reporting agency that had calculated the score. FICO Guide was developed to offer consumers, and the lenders and brokers who served them, an interim score explanation service, while the Fair Isaac pursued several options for disclosing FICO scores directly to consumers FICO Guide was phased out shortly after Fair Isaac launched its score disclosure and explanation service five months later via myFICO.com.

***The First On-Line Consumer Service That Provides FICO Scores & Explanation Directly To Consumers*.** On January 11, 2001, Fair Isaac and Equifax announced their agreement to create the first service that explains and delivers credit scores directly to consumers, accompanied by the underlying Equifax credit report and a score explanation by Fair Isaac. In their announcement, Fair Isaac explained that "We will provide the tools to not only review an individual's credit information, but to help them understand how that data may be analyzed to predict the risk associated with a credit application."  The companies began offering their new service online on March 19, 2001.

***Personalized FICO Score Simulation.*** On May 21, 2002 Fair Isaac revolutionized consumer credit education when it introduced its FICO Score Simulator on www.myFICO.com, as a free service for customers who purchase a score explanation service.[6] The FICO Score Simulator uses consumers' own credit information and FICO scores to help them see how specific future actions they might take could change their FICO score, and learn what's most important to achieve and maintain good credit health.  Consumers can see how their FICO scores would respond to any of a variety of actions ranging from paying all their bills on time for the next month, to declaring personal bankruptcy.

**Fair Isaac Provides Considerable Free Credit Score Educational Information**.

As noted above, Fair Isaac provides consumers with free educational information on FICO scoring directly from its web site, and in booklet form.[7] Free content on www.myFICO.com includes a weighting of the credit report factors evaluated by the FICO score so that consumers know what events or behavior has the greatest influence on the scores in general.  The following is sample of free content, taken directly from www.myFICO.com.[8]

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[6] A sample of the FICO Score Simulator is accessible at

http://www.myfico.com/Content/Samples/Sample_ScoreSimulator.asp?ReportID=1&ProductID=1

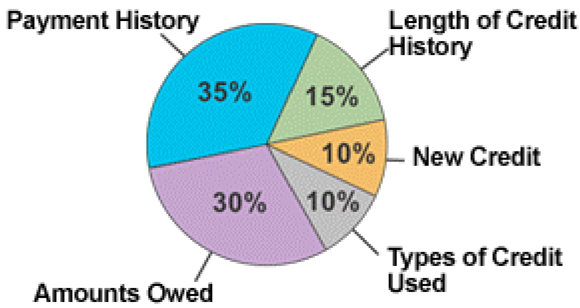
[7] See Attachment 6 available free at
http://www.myfico.com/Offers/RequestOffer.asp.

[8] Accessible at http://www.myfico.com/myfico/CreditCentral/ScoreConsiders.asp

## What's in Your Score

Email This

FICO Scores are calculated from a lot of different credit data in your credit report. This data can be grouped into five categories as outlined below. The percentages in the chart reflect how important each of the categories is in determining your score.




These percentages are based on the importance of the five categories for the general population. For particular groups - for example, people who have not been using credit long - the importance of these categories may be somewhat different.

### Payment History

- Account payment information on specific types of accounts (credit cards, retail accounts, installment loans, finance company accounts, mortgage, etc.)
- Presence of adverse public records (bankruptcy, judgements, suits, liens, wage attachments, etc.), collection items, and/or delinquency (past due items)
- Severity of delinquency (how long past due)
- Amount past due on delinquent accounts or collection items
- Time since (recency of) past due items (delinquency), adverse public records (if any), or collection items (if any)
- Number of past due items on file
- Number of accounts paid as agreed

### Amounts Owed

- Amount owing on accounts
- Amount owing on specific types of accounts
- Lack of a specific type of balance, in some cases
- Number of accounts with balances
- Proportion of credit lines used (proportion of balances to total credit limits on certain types of revolving accounts)
- Proportion of installment loan amounts still owing (proportion of balance to original loan amount on certain types of installment loans)

### Length of Credit History

- Time since accounts opened
- Time since accounts opened, by specific type of account

- Time since account activity

**New Credit**

- Number of recently opened accounts, and proportion of accounts that are recently opened, by type of account
- Number of recent credit inquiries
- Time since recent account opening(s), by type of account
- Time since credit inquiry(s)
- Re-establishment of positive credit history following past payment problems

**Types of Credit Used**

- Number of (presence, prevalence, and recent information on) various types of accounts (credit cards, retail accounts, installment loans, mortgage, consumer finance accounts, etc.)

Please note that:

- **A score takes into consideration all these categories of information, not just one or two.** No one piece of information or factor alone will determine your score.
- **The importance of any factor depends on the overall information in your credit report.** For some people, a given factor may be more important than for someone else with a different credit history. In addition, as the information in your credit report changes, so does the importance of any factor in determining your score. Thus, it's impossible to say exactly how important any single factor is in determining your score - even the levels of importance shown here are for the general population, and will be different for different credit profiles. What's important is the mix of information, which varies from person to person, and for any one person over time.
- **Your FICO score only looks at information in your credit report.** However, lenders look at many things when making a credit decision including your income, how long you have worked at your present job and the kind of credit you are requesting.
- **Your score considers both positive and negative information in your credit report.** Late payments will lower your score, but establishing or re-establishing a good track record of making payments on time will raise your score.

The Web site's educational information also lists and discusses the kinds of information NOT included in calculating FICO scores.[9] These extend well beyond the prohibited factors listed in the Equal Credit Opportunity Act.

**What's Not in Your Score** — Email This

FICO scores consider a wide range of information on your credit report. However, they do not consider:

- **Your race, color, religion, national origin, sex and marital status.**
  US law prohibits credit scoring from considering these facts, as well as any receipt of public assistance, or the exercise of any consumer right under the Consumer Credit Protection Act.
- **Your age.**
  Other types of scores may consider your age, but FICO scores don't.
- **Your salary, occupation, title, employer, date employed or employment history.**
  Lenders may consider this information, however, as may other types of scores.
- **Where you live.**
- **Any interest rate being charged on a particular credit card or other account.**
- **Any items reported as child/family support obligations or rental agreements.**
- **Certain types of inquiries (requests for your credit report).**
  The score does not count "consumer-initiated" inquiries - requests you have made for your credit report, in order to check it. It also does not count "promotional inquiries" - requests made by lenders in order to make you a "pre-approved" credit offer - or "administrative inquiries" - requests made by lenders to review your account with them. Requests that are marked as coming from employers are not counted either.
- **Any information not found in your credit report.**
- **Any information that is not proven to be predictive of future credit performance.**
- **Whether or not you are participating in a credit counseling of any kind.**

[9] Accessible at http://www.myfico.com/myFICO/CreditCentral/ScoringWorks/FICOIgnores.asp

The Web site also provides free advice on actions consumers should take -- or avoid taking -- to improve FICO scores over time.[10]

**Improving Your Score** Email This

It's important to note that raising your score is a bit like losing weight: It takes time and there is no quick fix. In fact, quick-fix efforts can backfire. The best advice is to manage credit responsibly over time. To see how much money you can save by just following these tips and raising your score, click here.

**Payment History Tips**

- **Pay your bills on time.**
  Delinquent payments and collections can have a major negative impact on your score.
- **If you have missed payments, get current and stay current.**
  The longer you pay your bills on time, the better your score.
- **Be aware that paying off a collection account will not remove it from your credit report.**
  It will stay on your report for seven years.
- **If you are having trouble making ends meet, contact your creditors or see a legitimate credit counselor.**
  This won't improve your score immediately, but if you can begin to manage your credit and pay on time, your score will get better over time.

**Amounts Owed Tips**

- **Keep balances low on credit cards and other "revolving credit".**
  High outstanding debt can affect a score.
- **Pay off debt rather than moving it around.**
  The most effective way to improve your score in this area is by paying down your revolving credit. In fact, owing the same amount but having fewer open accounts may lower your score.
- **Don't close unused credit cards as a short-term strategy to raise your score.**
- **Don't open a number of new credit cards that you don't need, just to increase your available credit.**
  This approach could backfire and actually lower score.

**Length of Credit History Tips**

- **If you have been managing credit for a short time, don't open a lot of new accounts too rapidly.**
  New accounts will lower your average account age, which will have a larger effect on your score if you don't have a lot of other credit information. Also, rapid account buildup can look risky if you are a new credit user.

**New Credit Tips**

- **Do your rate shopping for a given loan within a focused period of time.**

[10] Accessible at http://www.myfico.com/myFICO/CreditCentral/ScoreConsiders/Tips/AmountsOwedTip.asp

FICO® scores distinguish between a search for a single loan and a search for many new credit lines, in part by the length of time over which inquiries occur.

- **Re-establish your credit history if you have had problems.**
  Opening new accounts responsibly and paying them off on time will raise your score in the long term.
- **Note that it's OK to request and check your own credit report.**
  This won't affect your score, as long as you order your credit report directly from the credit reporting agency or through an organization authorized to provide credit reports to consumers.

**Types of Credit Use Tips**

- **Apply for and open new credit accounts only as needed.**
  Don't open accounts just to have a better credit mix - it probably won't raise your score.
- **Have credit cards - but manage them responsibly.**
  In general, having credit cards and installment loans (and paying timely payments) will raise your score. Someone with no credit cards, for example, tends to be higher risk than someone who has managed credit cards responsibly.
- **Note that closing an account doesn't make it go away.**
  A closed account will still show up on your credit report, and may be considered by the score.

Other educational information offered free to consumers on the Web site includes: ways in which credit scores help consumers; information on credit reports and what to do if a credit report error is suspected; over 50 different financial calculators to help consumers manage their money; and, an extensive section of Frequently Asked Questions[11] regarding credit scoring and the site's consumer products such as:

**FICO® Scores**
What is a FICO score?
How can I improve my FICO score?
What's the most important factor in a Score?
Do insurance companies look at FICO credit risk scores?
What do FICO scores ignore?
What is a good FICO score?
How often does the score change?
How are the FICO scores calculated?
What are the highest and lowest FICO scores?
Why do lenders use FICO scores?
Does everyone have a FICO score?
What is a BEACON score?
Will ordering my FICO® score cause it to drop?
Will my score actually change over time?
Is my score more likely to go up or down?

[11] Accessible at http://www.myfico.com/myfico/FAQ.asp

Fair Isaac has also pioneered new tools to help consumers better understand what influences their scores and how their scores affect lender decisions. On March 6, 2002, the company introduced a free interest-rate service on www.myFICO.com that matches consumer FICO scores with current interest rates currently charged by lenders for 18 different types of mortgage and auto loans.[12] The service helps consumers quickly understand how getting a better FICO score can translate into more attractive credit terms and significant dollar savings over time. The interest rate information is collected daily by Informa Research Services, Inc.

**FICO Scores are Readily Available to Consumers**.

Today Fair Isaac provides FICO® scores, directly to consumers through several distribution channels. These scores are always accompanied by key supplementary information that helps the consumer understand and use the score: the consumer's underlying credit report and Fair Isaac's personalized score analysis including the score range, where the consumer's score falls on that range, what factors contributed most to their particular score and how to improve their score given those factors over time. At www.myFICO.com, consumers can get their FICO score calculated from data in their consumer credit report provided by any of the three national credit reporting agencies: Equifax, Experian and TransUnion. For $12.95 the basic service provides the consumer's FICO score, Fair Isaac's personalized explanation of the score and suggestions for improving it over time, the underlying credit report information from which the score was calculated, and access to the FICO Score Simulator.

In addition, the Web site offers several other services based on the consumer's FICO score:

- FICO Saver for Homebuyers shows consumers how their FICO score and other information will likely be evaluated by mortgage lenders, and helps consumers realistically assess the maximum loan amount they can comfortably handle.

[12] Accessible at http://www.myfico.com/myfico/CreditCentral/LoanRates.asp.

- 3 Bureau Report with FICO Score provides consumers with all three credit reports plus their FICO score calculated by TransUnion and Fair Isaac's score explanation, for a complete view of their credit history.
- Equifax Credit Watch is the comprehensive credit-monitoring service for consumers concerned about the risk of identity theft.
- myFICO Credit Advantage helps consumers track changes in their FICO score and credit report over one year.

Fair Isaac has also worked with the credit reporting agencies such that those credit reporting agencies can also provide FICO scores directly to consumers, accompanied by the underlying credit report and Fair Isaac's personalized explanation and suggestions for improving the score over time. As of today, Equifax and TransUnion both offer FICO Scores and explanation service via their websites as well.

**FICO Score Explanation by Mail**

Fair Isaac has expanded its consumer education initiative to make FICO score education available to consumers who may not have convenient access or who choose not to obtain it over the Internet. Fair Isaac collaborates with Intersections, a company that provides credit information and credit monitoring services to consumers both online and via U.S. Mail. This includes a 3-in-1 credit report that provides credit reports from all three bureaus, the consumer's FICO score calculated by TransUnion, and Fair Isaac's score explanation.

In addition, Fair Isaac also works with a variety of businesses to create new channels that consumers can use to access FICO score-based consumer services and information. These businesses include some of the nation's leading financial service providers, as well as financial management solution providers such as Quicken.com, and non-profit credit counseling organizations such as Springboard and Consumer Credit Counseling Service of Santa Clara and Ventura Counties.

**Alerting the Public to FICO Score Availability**. Even though Fair Isaac has worked diligently to let consumers know what information about FICO scores is available, the biggest challenge remains getting the word out. Since June, 2000, Fair Isaac has welcomed and encouraged media coverage on the importance to consumers of credit scores and Fair Isaac's efforts to empower and educate consumers with scores and related information. The media's response has been extremely helpful to consumers and includes articles and broadcast coverage in hundreds of outlets including *The Wall Street Journal*, *The New York Times*, *USA TODAY*, *Newsweek*, *NBC Network News*, *National Public Radio*, and *The Today Show*. Traffic at the myFICO.com site increases after each significant media event.

On January 26, 2003, Fair Isaac promoted credit score awareness in a television commercial on credit scoring aired during the Super Bowl. The educational ad highlighted the importance of credit scores in determining consumer interest rates on mortgage and auto loans, and referred viewers to www.myFICO.com for more information.[13]

In a further effort to increase public awareness, this past May 5-6, Fair Isaac hosted numerous consumer advocacy organizations for an intensive discussion on credit scoring and the best ways to reach consumers, especially underserved consumer groups, with credit scoring information that can help them improve their overall credit health. Participants included representatives from such organizations as Consumer Action, La Raza, and Operation Hope.

**Solutions to Improve Financial Literacy**

While there is a whole range of excellent score education material available to consumers today, there are improvements that can be made to solve problems that are inhibiting greater financial literacy of American consumers.

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[13] The ad can be viewed at > http://wip2.space150.com/myfico/myfico_future/

**<u>Problem</u>: Scores that are not commonly used by lenders are marketed to consumers looking for information to improve their financial literacy.** Consumers, unaware of which credit scores are actually used by lenders to make decisions about credit, unknowingly purchase information about other credit scores that are not commonly used by lenders in making lending decisions. In some cases, purveyors of these credit score services launch massive marketing campaigns to induce consumers to purchase their score services without clearly disclosing the extent to which the scores they provide and explain are actually used by lenders. Consumers who unknowingly purchase such services may be confused when the credit score they purchase is different than the broad-based credit score used by their lender. In some cases, steps taken by the consumer to improve another score may not have the same effect on the credit score that lenders use.

To be well-educated, consumers should understand the measure lenders are using, and know the score the lender will use to evaluate them. Colleges typically use the SAT score to evaluate students who apply for admission. Students know this and use that same score to decide where to apply based in part on which colleges might accept them. Although a different aptitude test might provide the student with some useful information, prospective students get the greatest benefit from knowing their own SAT score, empowering them to judge for themselves how they might be viewed by a college admissions office. The same is true for credit scores. Educated consumers should know and understand the credit score that lenders use.

**<u>Solution</u>: Consumer Choice and Education.** We believe the solution to this problem is to educate consumers so they can make informed choices about purchasing score explanation services, and can decide what is most useful for them. The Senate can help consumers by improving upon the California score disclosure law[14] upon which SB 1370 and HR 2622 are

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[14] Fair Isaac has consistently supported **effective** score disclosure legislation. Fair Isaac did so in testimony in May of 2000, before the California State Senate Business and Professions Committee regarding SB 1607 that mandated credit score disclosure and eventually became California law. Fair Isaac again supported **effective** score disclosure in September of 2000, in testimony before the U.S. House Subcommittee on Financial Institutions and Consumer Credit,

patterned and promote a policy designed to provide the score most likely to help consumers and empower consumers to choose the available score that will be most useful to them.

__Problem__: **Consumers are confused because many of the scores provided to consumers as mandated by current state laws are not commonly used by lenders.** Under current California and Colorado score disclosure law, the credit reporting agency chooses the credit score it discloses to consumers and, other than in the context of a residential real estate transaction, the consumer cannot choose to get another score, even if that other score is more useful to the consumer. Two of the three national agencies are disclosing their own proprietary scores in compliance with the California disclosure law and do not give the consumer the option to obtain other broad based credit scores that these agencies widely distribute to lenders.[15] The proprietary scores these agencies choose to make available to consumers are not nearly as widely distributed to lenders as others distributed by those agencies.

Fair Isaac's consumer support line gets calls from consumers confused by scores other than FICO scores that they have obtained. For example, consumers have reported they have closed a number of accounts, after which the score they have obtained increased, but their FICO score did not. When we explain to them that the score they based their actions on was not a "FICO" score their reaction is often a version of:

- "What good is that score if it's not what lenders use?"
- "This is confusing people"
- "Why don't the bureaus provide the FICO score?"

In such circumstances, it is harder to help the consumer understand credit scoring because the confusion and frustration from the different score must be overcome before actionable education

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including testimony that Fair Isaac "supports disclosure of scores to consumers provided that such disclosure is conducted in a manner that provides meaningful and helpful information to consumers."

[15] Fair Isaac has agreements with one agency authorizing it to disclose FICO scores to consumers to comply with California and Colorado score disclosure laws. Fair Isaac is willing to enter into similar agreements with the other credit reporting agencies.

can begin. If consumers are given a choice of scores widely distributed by the agencies, there will be less confusion and more education.

**<u>Solution:</u> Provide the score that is most likely to be helpful, and give the consumer the right to get a different widely distributed score if the consumer so chooses.**

The consumer should be equipped with the credit score that can best help him or her learn how lenders evaluate credit risk, and empowered to choose from the broad-based credit scores that are widely distributed by the bureau.

Existing legislative proposals should be improved by:

(1) Adding the name of the credit score and the name of the third party developer, if applicable, to the information about credit scores that credit reporting agencies must disclose to the consumer.[16] With this information, the consumer is empowered to seek out additional, accurate information about the credit score that matters to them. It also empowers the consumer to effectively compare the credit score information it gets from the credit reporting agency to information from lenders and other sources.

(2) When a consumer requests disclosure of a credit score, the credit reporting agency should be required to disclose the broad-based credit score that it most widely distributes to lenders. In addition, put the consumer in control by allowing him or her to request and receive at their choice one of either: (i) a broad-based credit score that the credit reporting agency widely distributes to lenders, or (ii) the general education credit scores current state law and HR 2622 already allow the bureau to provide.[17] Protect the credit reporting agency from uncooperative third party score developers by adding another exception that would relieve the agency from the obligation to disclose the developer's score if the third party developer refuses to authorize such disclosure at a reasonable fee. Limit the burden on the agency and the complexity of the regulation by

[16] This requirement could easily be added to the disclosures proposed in Section 3 (a) of SB 1370 and to HR 2622.

[17] This requirement could easily be added to the disclosures in proposed for Section 609 (d) (2) by Section 3 of SB 1370 and to HR 2622.

limiting the disclosure requirement to one model from the agency and one model from each third party that develops models for broad based credit scores widely distributed by the agency.[18]

The above suggestions to improve existing proposals add to the choice and education available to consumers without placing a significant, additional burden on either the credit reporting agencies or score developers. Nothing forces a third party developer to make its score available. If the third-party refuses to authorize disclosure at a reasonable fee, the agency has no obligation to offer the score. The number of different scores the agency must offer is limited because an agency must offer a score only if the score is a broad based credit score that the agency widely distributes to lenders, and then only one score from each such third party developer. Moreover, the legislation is flexible and will adapt as the credit scores used by lenders change. As a particular score becomes more widely distributed to lenders, it will be more useful to consumers and therefore it will be requested more often. When a new score becomes the broad-based credit score most widely distributed to lenders by that credit reporting agency, the score provided to consumers who do not exercise a choice will change to the score that is most likely to be helpful to the consumer. Existing score disclosure proposals can and should be modified to give consumers more choice and to continue to improve consumer credit education.

## Credit Score Regulatory Overview.

"I will say to you that it is very important to us to maintain a system which enables those models and those technologies to advance, because if they don't we're probably going to find that costs -- interest costs and availability for credit to the average consumer are likely to rise."

Alan Greenspan, Testifying about credit scoring at the July 15, 2003 House Committee on Financial Services Hearing on Monetary Policy.

We believe that Chairman Greenspan can comfortably make the above cautionary statement because existing regulation and oversight by various governmental agencies is working well.

[18] These protections could easily be added to the Limitations proposed for Section 609 (d) (1) in Section 3 (b) of SB 1370 and to HR 2622.

Credit scores are one of many methodologies used by lenders to make better lending decisions, and every lender is required by law to use those methodologies in compliance with applicable laws, including the Equal Credit Opportunity Act. Regulation B, promulgated under the ECOA, prohibits lenders from using prohibited bases in the lending decision, such as race, marital status, religion and national origin. Consumer reporting agencies do not collect that information, except what may be collected in accordance with identifying the consumer. That identifying information is not utilized in Fair Isaac's scoring models. Consumer reporting agencies collect data in five general categories. 1. Header Information that identifies the consumer, such as name, address, date of birth, Social Security Number; 2. Trade Lines (for account information); 3. Public Records; 4. Collections; 5. Inquiries. Fair Isaac's credit bureau scoring models do not utilize any of the header information in category 1.

The OCC and other banking regulatory agencies have access to published Performance Charts for the Fair Isaac Credit Bureau Risk Scores. Fair Isaac periodically produces those Performance Charts (also called Validation Odds Charts) from new national credit bureau data samples used for model update purposes. These charts demonstrate and prove that the FICO score rank-orders consumers according to repayment risk.

Clients for whom Fair Isaac develops custom models are provided a suite of development statistics with each custom model development so the client may share that information with examiners. These statistics demonstrate the rank-ordering of payment performance for the client's specific portfolio based on their specific definition of "bad" payment performance. Fair Isaac also provides information on the individual characteristics that make up the client's custom models. These statistics show the predictive content contained in each characteristic and illustrate why the scorecard contains the characteristic mix that it does.

Fair Isaac also provides complete score tracking standards so that the client is able to monitor the performance of the model and scores, and track changes in the profile of their population over time. The OCC and other banking regulatory agencies have access to these performance statistics and tracking standards, as of course do the banks themselves.

One way lenders are assured their use of Fair Isaac credit scores complies with existing regulations is the following warranty and representation found in Fair Isaac's contracts with the credit reporting agencies and end-user lenders:

> Fair, Isaac, the developer of [insert score name], warrants that the scoring algorithms used in the computation of the [insert score name] Score are empirically derived from [insert name of ] credit data and are a demonstrably and statistically sound method of rank-ordering candidate records with respect to credit risk, and that no scoring algorithm used by [insert score name] uses a "prohibited basis" as that term is defined in the Equal Credit Opportunity Act and Regulation B ("Reg. B") promulgated thereunder.

Regulatory agencies charged with overseeing the safety and soundness of lenders have a variety of regulations pertaining to credit scoring such as the OCC's Bulletin 97-24, dated May 20, 1997. (accessible at *http://www.occ.treas.gov/ftp/bulletin/97-24.txt* )

**Regulators are Well Trained to Oversee Lender's Use of Credit Scoring**

Fair Isaac has actively partnered with many regulators for many years to help ensure there is informed and effective oversight of the use of credit scoring.

Office of the Comptroller of Currency. Right after the above OCC bulletin was issued in June of 1997, Fair Isaac hosted three representatives of the OCC at an interactive scorecard engineering meeting at which scorecard engineering was demonstrated to help the OCC understand the methodology used to develop credit scorecards. Fair Isaac has continued to work with the OCC since then, such as the two-day seminar on April 10-11, 2002 in Dallas entitled "Making the Most of Scoring Tools." The seminar covered scoring concepts, model development, implementation issues, uses of scores in strategies across the account lifecycle, and tracking & validation. The seminar focused on both custom application risk models and Fair Isaac credit bureau risk scores.[19] .

Federal Financial Institutions Examination Counsel.[20] On June 4, 2002, approximately 205 examiners from the Federal Reserve, OCC, OTS, FDIC, NCUA, and Farm Credit Administration attended a day-long seminar, "Making the Most of Scoring Tools", covering scoring concepts, model development, implementation issues, and tracking & monitoring, and focused on custom application risk models and the Fair Isaac credit bureau risk scores.[21]

Office of Thrift Supervision. Fair Isaac has delivered a series of two-day seminars for the OTS (Nov. 2001, April 23-24, 2002 and Oct. 15-16, 2002, April 22-23, 2003) focused on the Fair Isaac credit bureau risk scores and pooled application risk models. Fair Isaac is scheduled to deliver another seminar in 2003 and two, two-day seminars in each of 2004 and 2005.[22]

**Conclusion**

Fair Isaac is proud of its role in providing actionable credit score information to empower consumers to improve their financial literacy and is committed to continuing its efforts in both the regulated and private disclosure of credit scoring information. I thank you for the opportunity to share with you Fair Isaac's expertise and experience in this important area.

[19] See Agendas, Attachment 7

[20] The FFIEC was established in 1978 and consists of the Chairpersons of the FDIC and the National Credit Union Administration, the Comptroller of the Currency, the Director of the OTS, and a Governor of the Federal Reserve Board appointed by the Board Chairman. The FFIEC's purpose is to prescribe uniform federal principles and standards for the examination of depository institutions, to promote coordination of bank supervision among the federal agencies that regulate financial institutions, and to encourage better coordination of federal and state regulatory activities.

[21] See Agendas, Attachment 7

[22] See Agendas, Attachment 7