INFORMATION POLICY INSTITUTE

# The Fair Credit Reporting Act: Access, Efficiency, and Opportunity

iNFORMATION policy institute

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## *AGENDA*
### *Introduction*

- More information = Less risk
- National credit reporting system:
  - Maximizes fairness & efficiency
  - Broadens consumer access to credit
  - Reduces price of credit to consumers

# *Research design and methodology*

- Credit Scoring tested against differing types of data (quantity and quality)
- Relationship between preemption and quality of data in credit reports
- Relationship between quality of data in credit reports and access to and price of credit

## *3 case studies of impacts:*

- Automated underwriting (mortgages)
- Prescreening (credit cards)
- Full-file credit reporting (the ability to assess risk)

## ***PRESCREENING***
## ***Methodology***

- Surveyed 7 major credit card issuers
- Account for 281 million existing Visa and MasterCard accounts

***Build a Model to measure impact of loss of preemptions:***

- Estimate increase in costs
- Estimate impact on access to credit
- Evaluate the unit cost of the acquisition method

# *FULL-FILE CREDIT REPORTING*
## *Issues*

***Questions:***

- Will changes in the law (failure to reauthorize) affect credit report data?
- Will changes in data affect the ability of lenders to make credit decisions:
  - Credit approval
  - Price of credit
  - Effect on underserved groups

## ***FULL-FILE CREDIT REPORTING***
## ***Methodology***

***Six scoring models:***

- Four commercial scoring models (credit bureaus)
- Two proprietary credit card scoring models (credit card issuers)

***Data set:***

- Constructed by TransUnion
- From credit reports of approximately 3.6 million consumers selected at random
- Two points in time: December 2000 and December 2002.

# FULL-FILE CREDIT REPORTING

## Methodology: Defining Scenarios

| Criteria | Reductions in the Number of Data Furnishers | | Restrictions to the Type of Data Reported | |
|---|---|---|---|---|
| | Scenario A | Scenario B | Scenario C (Moderate) | Scenario D (Severe) |
| *Limitations on Reporting of Delinquent Accounts* | | | Purge trades with 30- or 60-day delinquencies | Purge trades with 30-, 60-, or 90-day delinquencies |
| *Limitations on Reporting of Paid Public Record Items* | | | Purge at 3 years | Purge when paid |
| *Limitations on Reporting of All Adverse Information* | | | Purge All Adverse Information at 5 years | Purge All Adverse Information at 4 years |
| *Limitations on Use of Inquiries in Models* | | | All 30 day clustered inquiries count as one. | Purge all but one inquiry less than 60 days |
| *Reduction of Trade-line Availability* | Two Information Service Providers Stop Reporting | 8 Major Credit Issuers stop Reporting | | |

# *Dubious Methodology*

- Co-variation is not causation – e.g. ? prescreened offers of credit <u>and</u> ? ID theft, <u>therefore</u> …. linked
- #1 – Reidenberg May 8 House Fin Services testimony
- #2 – 16 June *Privacy Times*

# *Dubious Methodology*

- VT, CA, MA – exempted from FCRA yet have most competitive home mortgage rates, credit access, etc.
- Exemptions are narrow, have nothing to do with scoring

# *Serious Methodology*

- Consumer Federation of America

  - Scientific method applied

  - Representative sample

  - Sound interpretation = no quantum leaps of logic

# *Research Findings*

- Automated Underwriting
- Prescreening
- Full-file credit reporting

# *AUTOMATED UNDERWRITING*

## *Findings*

### ***Faster processing:***

- Before AUS, approving a loan takes approximately three weeks
- in 2002, over 75 percent of all loan applications received **approval in two to three minutes**
- Benefits enabled by 1996 strengthened FCRA preemptions

# *AUTOMATED UNDERWRITING*
## *Findings*

***Reduction in origination costs:***

- Integration of automated underwriting at point of sale reduces origination costs by about **$1,500 per loan**
- Applied to the 12.5 million sales of existing homes in 2002, this would produce savings of **$18.75 billion.**

# *AUTOMATED UNDERWRITING*
## *Findings*

***Better performance and higher acceptance:***

- **Better Performance** -- AUS consistently outperforms manual underwriting (loans that do not default or experience serious delinquencies)
- **Higher approval rates** – one version of AUS increased “accepts” by 36% (Freddie Mac)
- **Serving traditionally underserved populations** – one version of AUS increased “accepts” to minorities by 29% (Freddie Mac)

## *New customer acquisition costs increase:*

- Model card issuer spends \$57.86 to acquire a new customer.
- Without prescreening, costs increase between \$60.78 and \$72.62.
- Without prescreening, total costs increase \$269 million to \$1.36 billion per year.
- Card issuer either raises price, reduces access, or both.

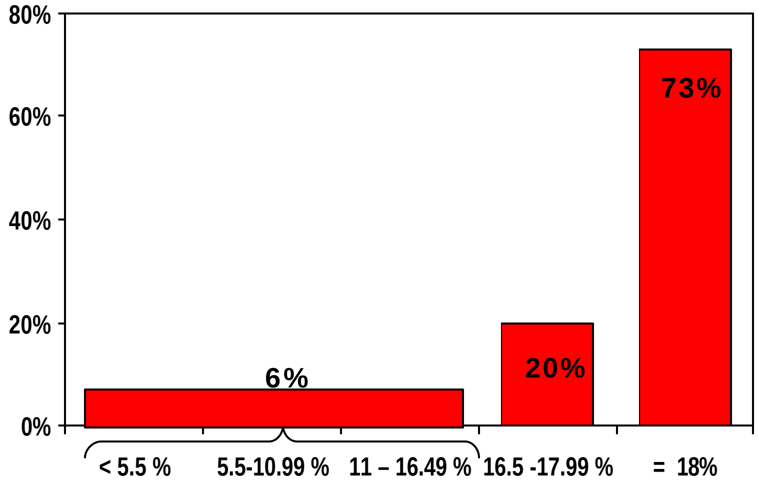
## Competitive Effect of Prescreening:

- Since 1997, consumer savings from competition in the credit card industry is an estimated **$30 billion per year.**

# *PRESCREENING*
## *Findings*

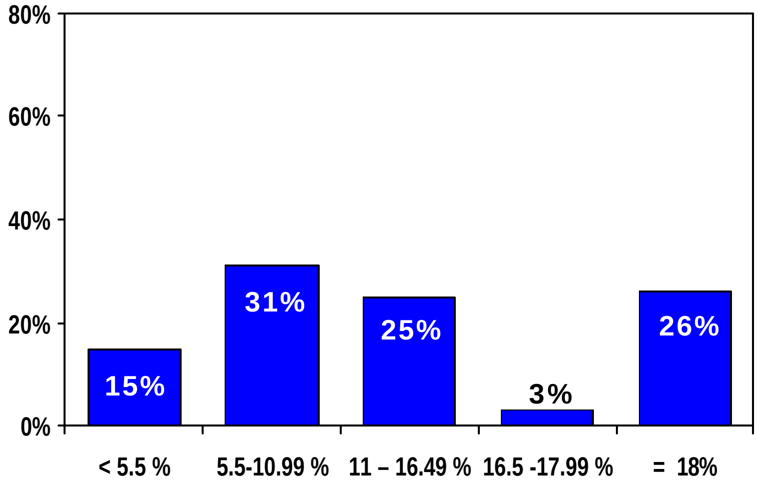
**Share of credit card holders by interest rate tier, 1990 and 2002**

**1990**




**Credit card interest rate tier**

**2002**




**Credit card interest rate tier**

## _Misconceptions About Prescreening:_

- Marketing vs. Scoring – misses competitive impact of prescreening
- Volume of prescreened offers of credit have increased, and incidence of ID theft has increased, therefore ….

## *Findings: Identity Theft*

### *Cost of Credit-Card Fraud:*

| Type | Year 2000 Cost (Millions) | % of Credit Card Fraud | % of Sales Volume |
|---|---|---|---|
| **False Applications** | $46.1 | **4.5%** | 0.004% |
| **Other Fraud** | $976.1 | 95.5% | 0.078% |
| **Total** | $1,013.2 | 100.0% | 0.082% |

## *PRESCREENING*
## *Findings: Identity Theft*

- Prescreened lists thoroughly checked by <u>both</u> credit bureaus and credit card issuers
- ID theft function of Information Economy, not a product of prescreening
- 60% to 80% of fraudulent applications identified before the accounts are ever opened

# FULL-FILE CREDIT REPORTING

## Findings: Wide Impact on Credit Scores

***State activity alters credit scores of a high proportion of consumers*:**

- Under each of the four scenarios, using Commercial Model #1, a TransUnion model, roughly 88 percent of consumers experience a change in their credit score.

# *FULL-FILE CREDIT REPORTING*

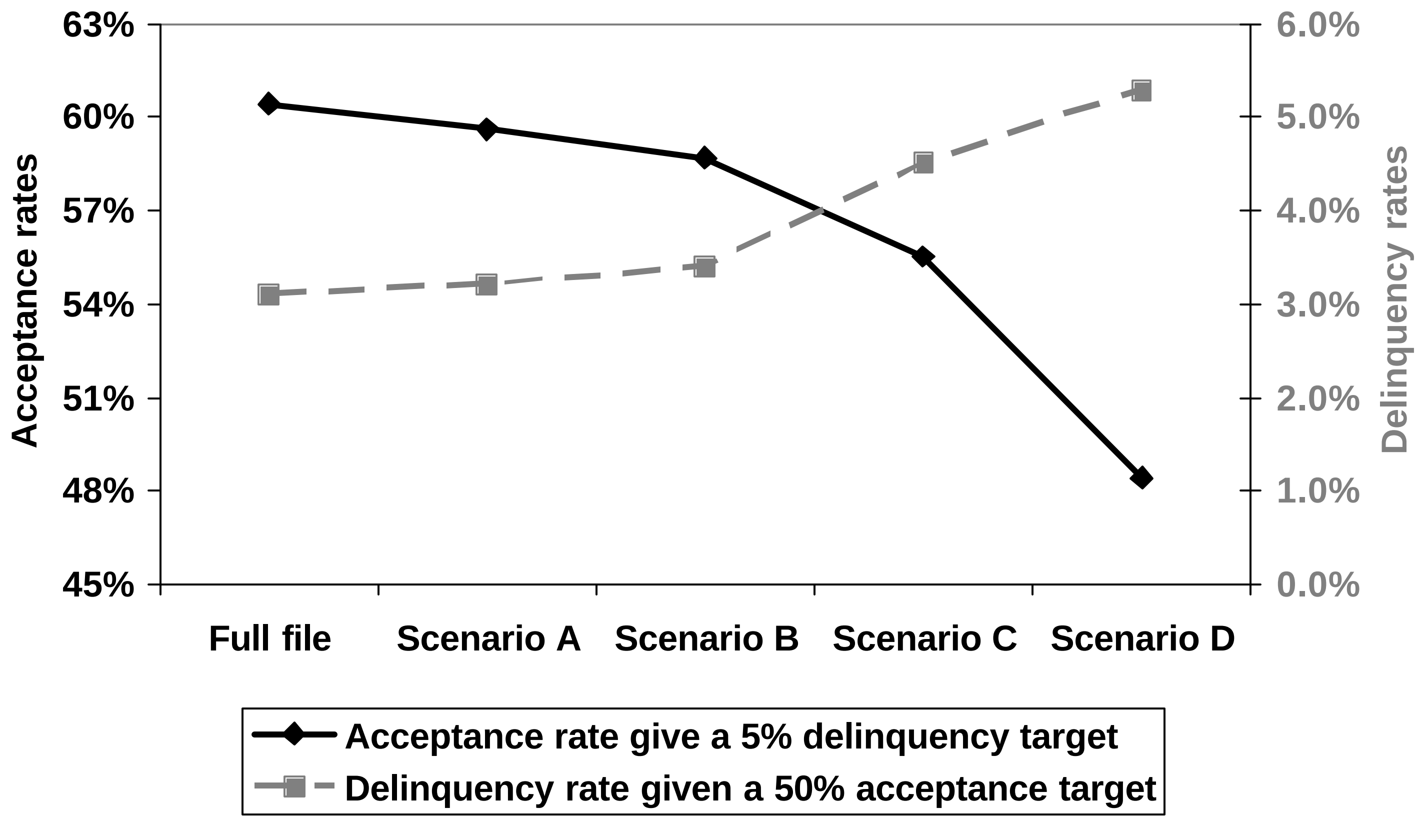
## *Findings: Loss of Predictive Power*

***<u>State activity degrades predictive power of scoring models</u>***

- Restrictions on derogatories have greatest impact
- In the most "severe scenario", the predictive power of the scoring models is reduced by <u>10 to 15 percent</u>.

# *FULL-FILE CREDIT REPORTING*

## *Findings: Steeper Trade-Offs*



# *FULL-FILE CREDIT REPORTING*
## *Findings: Steeper Trade-Offs*

***Holding acceptance rates constant causes delinquencies to increase under all four scenarios:***

- At standard acceptance rates, delinquencies would increase by between 10 and 70 percent.
- Cost to consumers an additional $3 to $22 billion per year, or $40 to $270 per year for the average American family.



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# *FULL-FILE CREDIT REPORTING*
## *Findings: Steeper Trade-Offs*

***Holding delinquencies constant causes acceptance rates to decrease under all four scenarios:***

- At current delinquency rate, between 10% and 30% of those now granted general purpose credit would be denied credit.

- This could prevent as many as 14 to 41 million people from receiving new credit card accounts.

# *CONCLUSION*
## *Preemption Provides Real Benefits*

***Make permanent the FCRA's current strengthened preemptive provisions:***

- **Essential facility** -- national credit system drives growth in US consumer economy
- **Real consumer benefits** -- increased access to credit at lower prices
- **Maximizes fairness and efficiency --** in consumer credit markets
- **Real loss of benefits --** without reauthorization of FCRA's strengthened preemptive provisions



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