Comment #: 16

August 9, 2004

CREDIT BUREAU SERVICES

Federal Trade Commission
Office of the Secretary
Room H-159 (Annex M)
600 Pennsylvania Avenue, NW
Washington, DC 20580

RE: Public Comment: FACT Act Scores Study, Matter No. P044804.

Dear Ladies and Gentlemen of the FTC and Federal Reserve Board,

Our family owned business had been an independent local credit bureau since 1905. Our company covered 32 counties and controlled close to 500,000 consumer credit files. In 1990, we began automating our credit files with a national company. It took us over 3 years to input our files. In 2001, our relationship changed; while still in the credit reporting business, we are now considered a "reseller."

Deterioration of the Credit File

Over the years, as a bureau, we fought many battles to maintain the integrity and quality of our credit reports; from credit grantors who only wanted to take credit information and not report it to national companies, who drove down the price of credit reports - to the point where no one could maintain a complete and accurate file. These trends destroyed the independent credit bureaus, where once there were 2,600(1) agencies assisting and educating both consumers and businesses, now there are only 200(2). These 2,600 agencies lived and worked in the area where the consumer resided and were able to resolve problems instantly. Today, it takes consumers months and sometimes years, to get problems resolved.

We also saw new FCRA laws implemented which have been counter productive to the goal of accurate credit information, such as the selling of prescreened lists. While this has been a boon to the direct marketing industry, credit card industry and the national CRAs, it has destroyed the quality of our country's credit files. Banks, in a battle to save their customers from being poached by others, or credit grantors in a fight to keep their customers from becoming enslaved to another lender, stopped submitting or submit incomplete credit trade information. And despite FTC warnings about reporting incomplete or partial trades, this practice continues yet today. Credit grantors are not going to jeopardize their most valuable asset, their customers, regardless of any FTC warning.

These situations have resulted in over 70% of our nations' credit reports contain errors (3).

Trends in Point Scoring

But today you are considering another aspect of the credit reporting industry: point scoring. Like credit reporting, this too has been around for many years.

Businesses have always sought to make the lending process easier, quicker and more accurate. However, it wasn't until automation, and the methodology for creating the "score" was hidden within a black box, that point scoring became "acceptable".

Prior to automation businesses tried numerous methods to determine risk, one such method was "red-lining." In "red-lining" creditors determined your interest rate based on where you lived. Today red-lining is illegal. And much like your objectives with this study, I believe that there are numerous factors within the point scoring that are disenfranchising millions of consumers and adversely affecting thousands of credit grantors.

Prior to automation, hundreds of point scoring models done on paper were evaluated and rejected by thousands of credit grantors. Never has, and never will, a point score predict whether a loan is good or bad or what risk is associated with the loan.

Individuals who had long been in the credit industry realize that scoring models are unable to properly attribute weight to the three "C"'s of credit - character, capacity and capital[4]. Credit reports continue to lack information on capital. Assets have always been used as a factor in lending, yet today by utilizing point scores, we completely ignore that area. Character is also absent. Paying ones bills is mostly a matter of character, and not financial capacity. I'm often amazed at professional people, who simply choose not to pay their bills. While those on fixed income, on a budget, manage to pay what is agreed. This lack of information and the inherent flaws within the "point scoring" system has not gone unnoticed.

The inability of a "software application" to properly weight the 3 C's of credit, combined with inaccurate or incomplete credit information, has resulted in a worthless and abusive point scoring system.

Polarizing Effect of Point Scoring

This one area of credit reporting has polarized our country. Daily we hear and see abuses that are occurring. Even reviewing the FTC public comments received on this matter shows the strong emotion that has been created by this unjust system.

Websites like www.creditscoring.com journals an individual's battle with the problems surrounding point scores, to another site called www.artofcredit.com encourages consumers to work the point scoring system by bumping (aka bumpage) hard inquires off and thereby increasing your point scores.

These websites and dozens of others like them are exposing the problems surrounding the point scoring system. These sites show individuals how to "work an automated method" to their advantage. The site www.artofcredit.com boasts of being composed of credit professionals and reports over 27 thousand articles and registered members approaching 2 thousand. On any moment of each day, this site has over 50 people on line.

These sites are filling a demand. A demand to understand both the credit reporting system and how point scoring works.

However, in their zeal to expose this broken system, these sites also advise people NOT to pay old debts or collection items because it will cause their point scores to go down. Another site called www.creditfactors.com actually discusses that "by filing bankruptcy you can increase your point score." Is this really what we want individuals to do?

A Bigger Picture

But there is a bigger issue at hand, these tactics are destroying our country's credit system. We are creating a society of consumers who believe it is "in their best interest" not to pay their bills because after two years Fair Isaac's point score doesn't count it against them.

We are creating consumers who understand how to work an automated system to increase their point scores but have little or no concept of financial acumen. With all the energy being spent on fighting flawed point scores, is there any wonder why our society, as a whole, is financially illiterate.

This problem carries additional concerns when we read that Congress determined "unfair credit reporting methods undermine public confidence which is essential to the continued functioning of the banking system.(5)" If their finds were true, then the task you undertake is of extreme importance.

Despite this severely broken "point scoring" system, I wish to share with you how we evaluated the effectiveness of point scores. The assessments of our studies are based on my 30+ years of working with consumers and businesses in the area of credit extension and debt recovery.

1995 Study

In April of 1995, we were first asked by a client to provide them point scores. In our desire to understand what we were selling, we drew point scores for a variety of individuals. Our study focused on debtors we were collecting on.

The scoring model we chose was "Reward[6]." It was to score the potential repayment of delinquent accounts. As a collection agency, we were familiar with these accounts. We selected 45 individuals that represented a cross of our files, from paid collections to unpaid collections. These were individuals that we felt would pay their accounts. Our goal was to determine how effective point scoring was within the collection industry.

Of the 45 debtors selected, 27 received a score of zero. 6 received a low score, below 300. 13 received a high score, over 300. Technically, this model said that we should be focusing on the 13 that received a score of 300+. If we had followed the scoring system, we would have worked only 13 of the 45 accounts or 28%. However, within 3 months of the study, 85% of all the accounts were recovered from across all scores. We concluded that point scoring did not work within the collection industry.

We then moved to a score utilized by credit grantors when opening new accounts, Empirica[6]. Individuals that participated included our board and selected individuals within our company. We also drew Empirica on the 19 debtors above that actually received scores. What we found concerned us greatly.

We found consumers buried in third party collection debt received higher point scores than individuals that were wealthy in assets. Even some senior staff received lower scores than some debtors. We then contacted TransUnion to discuss our findings. TU quickly referred us to Fair Isaac, the developer of TU's point score.

After an hour conversation, Fair Isaac informed us that the base scoring model was developed for the credit card industry, and therefore, focused its analysis on those items. They stated that point scores were only for a certain kind of portfolio. This certainly wasn't what Fair Isaac or the repositories were promoting.

I was left with the impression that consumers with few charge cards received high marks, thereby making them a target for credit card promotions.

Our 1995 study found that point scores resulted in two extremes. First, consumers who could ill afford more debt would be given more credit resulting in their being overextended; and second, those consumers that rely little on credit cards, and who could easily afford more credit would be denied most favorable rates.

After our study we made this information known to any business that requested utilizing point scores, and for many years we successfully impeded its use in our area by our clients.

However, over time, the business climate changed. Brokers were required to provide point scores and tri-merged credit report in order to meet underwriting requirements. This was in a large part due to Fannie Mae, a governmental agency. Fannie Mae's requirement resulted in "point scoring" being acceptable.

2004 Study

In preparing for this public comment, we again strived to "validate" point scores. We utilized the same type of groups as before.

While there were definite changes in the profiling - regretfully, in our opinion, the changes were not for the better. We reviewed 22 staff members who agreed to participate and 11 debtors.

The following groups all received a Zero Score.
- Individuals who had great credit, but no activity in 6 months.
- Individuals buried in unpaid collection & no trades.
- Individuals with 99% of all collections paid & no trades.

How can point scoring carry any value if these types of individuals are ALL viewed as the same?

We also determined that an Empirica score is normally about 50 points lower than the Trans-Risk(6) point score, shown on a consumer disclosure. All point scores now come with an average of three summary statements.

One participant who was refinancing her home received a Trans-Risk score of 799, yet the TransUnion score received by the mortgage lender, Bank of America, was 704. A difference of 95 points - on the very same credit report - on the very same day. Her consumer disclosure also listed a reason for the 799 score was "too many delinquencies," yet with over 17 tradelines, there was not ONE single delinquency or late payment. One has to question what other information, which is not being shown on the credit report, is being used to develop this score? If there is additional information, which the consumer is unaware of, how can they correct it?

One of the older participants, who had over 10 trade lines, open since 1975 with only one late pay, which that she says is incorrect; received a TransRisk score of 772, statistically her Empirica score would have been 722. That low of a score for this particular individual was shocking. Based of the 95 point difference from above, this individual could potentially have been classed subprime.

One of our younger participants with flawless credit and 15 tradelines, received a point score of 659. While another young participant with only one trade line received a point score of 639. How could this be? Both were below the normal 700 cutoff point. It appears that the younger an individual is, the lower their point score. This group is aggressively pursued by credit card offers. Yet, at the same time they are considered subprime by their score?

Individuals who had asset wealth and little revolving debt continued to get the lowest point scores. The independent farmers of our nation fall into this group. With large agriculture loans and self employed status, these individuals are being unjustly targeted.

Statements like, "Not enough revolving debt experience" on an individual with 12 R01 since 1982; one has to wonder, how much revolving debt experience is enough?

Or "No Accounts opened prior (to age of) 23"; since when is opening accounts after you are financially able to pay a detriment?

Once again we came to the conclusion that point scores are counterfactual.

Observations and Concerns

While attending a 2003 NCRA[7] conference, Fair Isaac encouraged the attendees to switch their clients to their "Next Gen" point scoring product. When questioned why, Fair Isaac stated that "the old scoring model didn't work." One has to wonder, if the old scoring didn't work, what makes anyone believe that the new one will?

I especially like Fair Isaac's quote in the paper on why point scoring works for insurance. They stated that "people who can't pay their bills tend to leave home late for work, and therefore get into more accidents." I would like to see the statistical/empirical evidence that backs up Fair Isaac's claim. Or are they really saying that people with low point scores, who use credit sparingly, tend to file more and larger claims?

What amazes me is the argument in favor of point scores - it allows for instant credit. However, instant credit had been around since the mid 1950's, well before computers and automation.

I believe that point scores were designed for one type of creditor - those that are predatory. Creditor's that fail to take into account all aspects of the loan, do no service to their customers or their business.

A recent article quoted a large bank as stating that they "expect increased demand for credit cards to offset any loan losses." What? I just wonder why loan losses are so bad? Could it be bad decisions based in inaccurate point scores? And how much more credit card debt can our country handle?

As our economy continues to weaken, and personal bankruptcies soar, and banks continue to rake in unearned profits from excessive credit card interest rates, I believe we will see a trend to move away from credit card usage. In fact, there are organizations such as Debtors Anonymous, who are showing consumers how to live without credit card debt, and membership in DA is growing. Much like the websites that I mentioned at the beginning, consumers will not sit passively by and become credit slaves. They will find a way to solve this problem, and it may not be how banks and credit grantors would like.

This reliance on point scores and its inability to differentiate and identify risk places an unforeseen systematic risk on our economy and our banking system.

Unless controlled, I fear this study is a waste of taxpayers money. With over 1,000 different point scores, there is no reasonable way to determine abuses. And with each business setting their own standards, the task becomes formidable. But I can assure you, based on our analysis, abuses do exist - if only to enslave the American public.

If you truly must see how broken the point scoring system is, just review Fannie Mae's default loans. Review and study historical data. I understand that most lenders take the middle score, not the most accurate score, but the middle. See if point scores worked for Fannie Mae? After all, they would have all three bureaus information. Did they give loans to individuals who could ill afford more credit? Which is more devastating to our economy and the consumer, being overextended in credit or being denied credit?

You could ask Ford Motor and or their employees to participate in the study. They are a big user of credit reports and point scores. One would think that company after company would want to participate in this effort. I would hope they all would want to make certain that their "point scores" are fair. Ask Farmers Insurance to participate, review the accounts where the rates were adjusted up. Did the adjustments occur mostly against those that are older? Does having no or few credit cards really justify increased insurance rates? I would believe that most consumers who had a rate increase would willingly participate.

Or even better yet, volunteer yourselves to the study - ask your family members to participate - your children, grandchildren, parents and grandparents - provide them with free credit scores and their credit report. Pull scores and reports on people you know. Then review with them what was found. I believe you will see numerous examples of negative or differential treatment.

Sincerely,

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Footnotes:
(1) Based on CDIA (former ACB) membership in the 1980's.
(2) Based on American Antitrust Institute's report on 9/19/03.
(3) Based on 1998 Study by Public Interest Research Group.
(4) Commonly accepted industry practice since the early 1900's.
(5) Parial quote from Congress' first finding of fact within the FCRA.
(6) TransUnion scoring products.
(7) National Credit Reporting Association.