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2012 FTC STUDY ON CREDIT SCORES: 98% ACCURATELY REFLECT CREDIT RISK

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I. INTRODUCTION

One of the Federal Trade Commission's ("FTC") many duties is to regulate the credit system in the United States. In 2003, Congress passed The Fair and Accurate Credit Transactions Act ("FACTA") and mandated that the FTC create a series of reports that document the prevalence of credit score inaccuracies. This note will explain the make-up of the credit reporting industry in the United States, describe the history of FACTA, summarize the first four reports from the FTC, and analyze the most recent report published by the FTC which includes the results of a study the FTC has planned and conducted since 2004. The finding that has garnered the most attention from the report is that one in every five consumers has an error in their credit report.[1] However, a more important statistic is being overlooked: approximately 98% of credit reports contain information that allows a lender to make an accurate risk assessment of potential borrowers.[2]

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[1] *In FTC Study, Five Percent of Consumers Had Errors on Their Credit Reports That Could Result in Less Favorable Terms for Loans*, FEDERAL TRADE COMMISSION, //ftc.gov/opa/2013/02/creditreport.shtm, (February 11, 2013); *Victimized By Credit* Reports, N.Y. TIMES (February 12, 2010), http://www.nytimes.com/2013/02/13/opinion/victimized-by-credit-reports.html?_r=1&; *The Accuracy of Information of Credit Reports*, http://www.amazon.com/Accuracy-Information-Credit-Reports-ebook/dp/B00BGCBK64 (last visited Oct. 5, 2013) (using the 20% error rate to describe the report in the Amazon market place; the report cost $4.99 on Amazon, but can be downloaded for free from the FTC website)[hereinafter *Media Coverage*].

[2] See FED. TRADE COMM'N, REPORT TO CONGRESS UNDER SECTION 319

II. THE CREDIT REPORTING INDUSTRY

The United States credit reporting industry is a private industry that collects and sells the personal and financial data of American citizens.[3] The data collected includes the following: identifying information, credit account information, public records including liens and legal judgments against the consumer's property, collection accounts and collection agencies, and inquiries from companies requesting the consumer's reports. Creditors, stores, and other establishments provide this data. The credit furnishers then give the information to the credit reporting agencies ("CRAs") voluntarily.[4] Currently, there are three national CRAs that control the market: Experian, Equifax, and Transunion.

The CRA's generate reports, known as risk scores or credit scores, and sell the reports to financial institutions and other companies that analyze financial risk.[5] The higher a person's credit score is, the more likely it is for a financial institution to do business with that person or charge a lower interest rate on the credit distributed. At the moment, the credit industry contains information on about 200 million consumers.[6] The effect that a consumer's credit score has on their ability to adequately control their financial future makes it critical that reports showcase an accurate portrayal of that person's financial history and is the reason why Congress has made an effort to regulate CRAs.

III. THE FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003

FACTA was passed by Congress in December of 2003[7] as a bipartisan measure to amend the Fair Credit Report Act of 1996 ("FCRA"). Congress enacted the FCRA to protect consumers amid the growth of the credit reporting industry. The

OF THE FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003, 47 (2012) [hereinafter *2012 FTC Report].*

[3] Amy S. Friend & Albert S. Jacquez, *The Fair Credit Reporting Act: Is it Fair for Consumers*, 5 LOY. CONSUMER L. REV. 81, 81 (1992-1993).

[4] *2012 FTC Report*, *supra* note 2, at 2-3.

[5] *Id.* at 2 n.6.

[6] *Id.* at 2.

[7] Fair and Accurate Credit Transactions Act of 2003, 15 USC §1601 (2003).

prevalence of inaccurate, misleading, irrelevant or outdated information in consumers' credit reports motivated congress to act.[8]

Members of Congress passed FACTA to address the same problems that caught the attention of their predecessors who enacted FCRA. The following provisions were included in FACTA to solve the problems Congress identified: (1) establish the right of every American to receive one free credit report a year; (2) mandate a warning notice to be sent out to consumers if a merchant is going to report negative information about them, and (3) establish a financial literacy commission, among other provisions.[9] The Senate and the House of Representatives shared the intention to improve the quality of credit information in the country and supported the passage of FACTA.[10]

IV. SECTION 319 OF THE FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003

FACTA imposed a duty on the FTC to create biennial reports on the status of the American credit industry starting in 2004 through 2014.[11] The study was meant to report on "the accuracy and completeness of information contained in consumer reports prepared or maintained by CRAs and find methods for improving the accuracy and completeness of such information"[12] The FTC completed its most recent report in December, 2012 and it was made available to the public in February, 2013. It differs greatly in methodology from previous studies about the credit industry.[13]

Section 319 of The Fair and Accurate Credit Transactions Act of 2003 states the following:

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[8] Amy S. Friend & Albert S. Jacquez, *The Fair Credit Reporting Act: Is it Fair for Consumers*, 5 LOY. CONSUMER L. REV. 81, 82 (1992-1993).

[9] H.R. Rep No. 149-2622, at p. 1-3 (2003) (Conf. Rep.) (Speech by Dennis Moore, U.S. Representative of the 3d Dist.of Kansas).

[10] 149 Cong. Rec. D1328-02, at p. S15570 (2003).

[11] Fair and Accurate Credit Transactions Act of 2003 §319, 15 USC §1601 (2003).

[12] *Id* at §319(a).

[13] *2012 FTC Report*, *supra* note 2, at 6, 8-9 (referring to reports done by US PIRG which only used consumer data; Policy and Economic Research Council, which used consumer, CRA and data furnisher data but used a sample representative of the U.S. census and not a sample of diverse credit scores; and The Federal Reserve Board, which only used CRA data).

> (a) STUDY REQUIRED.—Until the final report is submitted under subsection (b)(2), the Commission shall conduct an ongoing study of the accuracy and completeness of information contained in consumer reports prepared or maintained by consumer reporting agencies and methods for improving the accuracy and completeness of such information.
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> (b) BIENNIAL REPORTS REQUIRED.—
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> (1) INTERIM REPORTS.—The Commission shall submit an interim report to the Congress on the study conducted under subsection (a) at the end of the 1-year period beginning on the date of enactment of this Act and biennially thereafter for 8 years.
>
> (2) FINAL REPORT.—The Commission shall submit a final report to the Congress on the study conducted under subsection (a) at the end of the 2-year period beginning on the date on which the final interim report is submitted to the Congress under paragraph (1).
>
> (3) CONTENTS.—Each report submitted under this subsection shall contain a detailed summary of the findings and conclusions of the Commission with respect to the study required under subsection (a) and such recommendations for legislative and administrative action as the Commission may determine to be appropriate.

V. THE FOUR BIENNIAL STUDIES PERFORMED BY THE FTC PRIOR TO THE 2012 REPORT

The 2012 FTC Report is the first report, out of five total, conducted by the FTC and its researchers pursuant to §319 of FACTA ("Section 319") that produced significant data. The first four reports concentrated on constructing the methodology of the study.[14]

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[14] *See 2012 FTC Report*, *supra* note 2; *See* FED. TRADE COMM'N, REPORT TO CONGRESS UNDER SECTION 319 OF THE FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003, 2-3 (2010); *See* FED. TRADE COMM'N, REPORT TO CONGRESS UNDER SECTION 319 OF THE FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003, 2-3 (2008); *See* FED. TRADE COMM'N, REPORT

The first study in 2004 reported on the make-up of the credit system in the United States, studied the most likely places in the system to contain errors, researched other studies that have been done on the United States' credit system, and described a possible methodology to implement in a nationwide survey.[15] In the next biennial report in 2006, the FTC conducted a pilot study that focused on the most effective ways to generate useful results about credit score accuracy.[16] The FTC performed preliminary interviews with consumers and found that when there were problems with credit scores, consumers did not follow up and contest them; and the ones who did contest tended to have higher scores.[17] In order to get a representative sample of how the dispute process works and include consumers in various credit score ranges, the FTC decided to give researchers flexibility to be able to recruit participants and actively help them through the dispute process.[18]

The 2008 report implemented the findings of the previous pilot study and performed a second pilot study to fine tune the research process. The report found that 5.5% of the participants had material errors on their credit reports, however, the report concedes that the participants were not representative of the nation and therefore did not rely on the results as significant.[19] This pilot study was done to refine the study methodology, not collect statistics about the nation's credit system.[20]

The FTC and its researchers sent out mailings to entice people to join the study. They concentrated on informing many different demographics by sending out the mailings through various financial institutions as well as through a random

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TO CONGRESS UNDER SECTION 319 OF THE FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003, (2006); *See* FED. TRADE COMM'N, REPORT TO CONGRESS UNDER SECTION 319 OF THE FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003 (2004).

[15] *See* FED. TRADE COMM'N, REPORT TO CONGRESS UNDER SECTION 319 OF THE FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003, 1(2006).

[16] *Id*. at 2.

[17] *Id*. at 4.

[18] *Id*. at 6.

[19] *See* FED. TRADE COMM'N, REPORT TO CONGRESS UNDER SECTION 319 OF THE FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003, 1(2008) (Citing only seven out of 128 participants found a material error on their score).

[20] *Id*. ("the pilot studies serve only as a vehicle to improve the design of a national survey").

selection process where names were taken from public information sources.[21] Despite their efforts, the FTC still found that consumers with lower credit scores (generally under 760) were underrepresented.[22] Another problem the initial pilot study found was getting consumers to dispute errors on their reports once they were discovered. To solve this problem, researchers prepared dispute letters and provided pre-paid postage for consumers who identified an error.[23] The 2008 study left the FTC with two questions: (1) How to achieve a representative sample amid a likely non-response bias linked to consumers with lower credit scores; and (2) How to measure the effectiveness of the FCRA dispute process.[24]

The FTC answered the unresolved questions sufficiently enough to allow the Office of Management and Budget to approve the final study design in 2009. Subsequently, the 2010 FTC Report described the final study design.[25] The sample included 1,000 consumers randomly selected who reviewed their credit reports with an expert contracted for the study.[26] The FTC chose participants representative of the general population using the following factors: credit scores, age, gender, and regional diversity.[27] If a consumer found an error, the credit report was sent to the Fair Isaac Corporation ("FICO")[28] to categorize the potential error. FICO analyzed potential errors and informed the consumer whether the error would impact their credit score. The consumer then had the option to dispute the error through the FCRA dispute resolution process.[29] The FTC hoped the study would enlighten the public on the effectiveness of the FCRA dispute process and what type of information had the greatest

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[21] *Id*. at 6-7 (mailings were sent from the following institutions or lists: random direct mail, Members of Navy Federal, members of Commerce Bank, members VITA program, and miscellaneous contacts).

[22] *Id*. at 4; also *See Id* at 9.

[23] *Id*. at 8.

[24] *Id*. at 12 (considering non-response bias as the idea that there is a positive correlation between consumers who tend not to respond to invitations to the study and consumers who have low credit scores).

[25] FED. TRADE COMM'N, REPORT TO CONGRESS UNDER SECTION 319 OF THE FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003, 1(2010).

[26] *Id*. at 3.

[27] *Id*.

[28] FICO is a nationally recognized and respected credit score generator.

[29] FED. TRADE COMM'N, REPORT TO CONGRESS UNDER SECTION 319 OF THE FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003, 2 (2010).

effect on consumer's creditworthiness.[30]

VI. THE 2012 FTC REPORT

The FTC's goal when it mandated the biennial reports was to provide a reliable data set on the credit report accuracy in the United States.[31] This is consistent with the overall goals of FACTA, which include improving the resolution methods of consumer disputes and the accuracy of consumer records.[32] The FTC did not publish target goals for the amount of credit report inaccuracies expected in the system. Still, the results of the study were fit in the same ranges found in other studies done on the industry, even though the FTC used a different methodology than most of those studies.[33]

The main focus from most media outlets, including the official FTC press release regarding the report, was that 20% of Americans had an error on their credit report.[34] According to the report, 206 consumers of the participating 1,001 consumers had at least one error on their credit reports which was fixed after completing the FCRA dispute process.[35]

For consumers who care about practical effects on their credit score this figure is not the most relevant piece of data from the 2012 FTC study. For example, out of the 206 consumers with an error on one of their reports, only 129 ended up with a change in their credit score after the error was corrected. Thus, 13% of consumers had errors that actually affected their credit scores.[36] Moreover, not all the consumers who found errors in their credit reports found them on all of their credit reports. Except for a small percentage, each participant received three credit reports. Overall, 13% of all credit reports had errors, relatively less than the amount of total consumers who found errors (20%). This means, most errors were found on one or two of the reports

[30] *Id*. at 7.

[31] *2012 FTC Report*, *supra* note 2, at 1.

[32] Fair and Accurate Credit Transactions Act of 2003 Intro, 15 USC §1601 (2003).

[33] *2012 FTC Report*, *supra* note 2, at 55 (stating that a study done on credit report accuracy using only CRA information cited that 2.5%-12.5% of reports had errors and a study done using only consumer information found that 79% of reports had errors).

[34] *Media Coverage*, supra note 1, at 1.

[35] *2012 FTC Report*, *supra* note 2, at 36 (See table 4.1 *Data Summary*).

[36] *2012 FTC Report*, *supra* note 2, at 36 (See table 4.1 *Data Summary*).

instead of all three.[37] Any error on a consumer's credit report is troublesome, but if a consumer's entire credit history is not affected by the error because it only shows up selectively, it will have less of a negative impact.[38] The percentage of credit reports that resulted in an actual credit score change after the errors were fixed was 7%.[39] An actual score change is what hurts consumers in the market place, not the fact that an error exists. These figures reduce the importance of the actual effect of the 20% error rate on the American consumer.

The fact that that 13% of consumers have errors on their credit reports and 7% of all credit reports have errors that could cause a score changes is a more important than the fact that 20% of consumers have an error on a credit report. Ultimately, the effect of the error bares more importance than the mere existence of the error.

The impact that certain errors, or the subsequent credit score change, have on that consumer's ability to obtain credit is the most useful information for the consumer. This particular information is not as clearly stated in the report. The FTC claims there is "no established rule or threshold for classifying the significance of a credit score change as minor or major because the impact of a change in score is dependent on the current score."[40] Despite this, the FTC found evidence that lenders used the following ranges of FICO scores to group and indicate the risk of potential borrowers: 300-620, 620-679, 680-719, 720-779, and 780-850.[41] According to the 2012 FTC study, 2.2% of all credit scores resulted in a range increase from a credit score change, and no credit scores in the study resulted in a credit score decrease.[42] This means that almost 98% of all credit scores are reliable tools for lenders or other interested parties to use when calculating their risk for a deal involving the extension of credit to consumers, if relying on the credit score ranges used by the FTC. These numbers have the largest real world affect.

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[37] *2012 FTC Report*, *supra* note 2, at 36. (Out of the 1,001 participants 33 consumers were unable to obtain three credit reports making the sample size 2,968 credit reports as opposed to the expected 3,003 credit reports).

[38] *2012 FTC Report*, *supra* note 2, at 36.

[39] *2012 FTC Report*, *supra* note 2, at 36.

[40] *2012 FTC Report*, *supra* note 2, at 43.

[41] *2012 FTC Report*, *supra* note 2, at 45.

[42] *2012 FTC Report*, *supra* note 2, at 47.

VII. CONCLUSION

It is understandable that the FTC and others decided that the biggest takeaway from the 2012 FTC report was that one in five credit reports in America contain an error. Inherently, it is beneficial for consumers to check their credit histories and make sure they are correct. The piece of data that media outlets most widely reported will likely motivate consumers to do just that. A person's credit report is an intimate and private history of that person's financial life and should reflect each and every person accurately. Even if it is slim, there is a chance that finding an error on a credit report can put a consumer in a higher credit range.

On the other hand, FACTA was created to amend the FCRA and decrease inaccuracies in credit reports.[43] Section 319 of FACTA was narrowly tailored to create a study on the "accuracy and completeness of information contained in consumer reports" and to inform recommendations of ways to improve on the results. The study shows there is still room for improvement in our credit system, and the ultimate goal should be zero informational errors in our credit system. Nevertheless, the report contain a positive result: a large majority of America's credit reports, 98%, provide an accurate basis for a lender to assess the risk of potential creditors.

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[43] *See* Fair and Accurate Credit Transactions Act of 2003 Intro, 15 USC §1601 (2003).