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Abstract

The 1971 federal Fair Credit Reporting Act (FCRA) was intended to promote greater accuracy in credit reporting in the United States. Inaccurate credit reports can lead to overpricing on accepted loans, if not outright rejection. This paper examines how well the FCRA encourages accuracy within a voluntary and competitive reporting system.

There is ample evidence that credit files in the U.S. do not provide an exhaustive listing of all past credit experience for many borrowers. However, relatively little data exists about how often specific items contained in credit reports are wrong. Despite missing data, U.S. credit files are among the most comprehensive produced by any reporting system globally and support remarkably precise risk assessment tools. The role that the FCRA assigns consumers to inspect their own credit reports appears to be the most underutilized of all the existing tools for promoting even greater accuracy.

Introduction

The accuracy of consumer credit reports was among the most prominent issues in the Congressional debate over amending the Fair Credit Reporting Act (FCRA) during 2003. This came as no surprise to observers of the credit reporting industry and its evolution since the original FCRA was passed in 1970. As we will describe in greater detail below, the primary impetus for passage of the FCRA was to reduce widely recognized problems in credit report content. One of the FCRA's primary goals was to create a regulatory structure that would encourage the creation of credit history files that were factually correct and sufficiently descriptive of a consumer's credit usage so that businesses could rely upon the information to make products and services more readily available to consumers. Since implementation of the FCRA in 1971, accuracy in credit reporting has been a perennial issue.

A large part of the legislative balancing act undertaken in crafting the original FCRA was intended to foster accurate reports without discouraging reporting. The U.S. credit reporting industry is among the oldest in the world, dating back more than a century.[1] A hallmark of the U.S. reporting system is its reliance on voluntary reporting from thousands of furnishers of credit-related information. But the voluntary nature of the reporting process makes it particularly sensitive to the costs imposed by regulatory and legislative mandates. Consequently, over the past 32 years, Congress has been notably cautious about imposing new requirements on either bureaus or data furnishers without a clear indication of a problem that required legislative intervention.

During the summer of 2003, testimony before Congress juxtaposed contrasting views of how well the U.S. credit reporting system was performing. Consumer advocacy groups cited credit report inaccuracies in calling for legislation that would impose new procedures and legal liability on both credit bureaus and furnishers of credit report information. In making their case, these groups correctly pointed out that an inaccurate depiction of a consumer's credit history not only can trigger a rejection of a loan application, but with advent of risk-based pricing can also lead to overpricing loans for which the borrower is approved. Moreover, borrowers may not realize that the interest rate or fees they pay may be inflated due to inaccurate information from the borrower's credit report. One advocacy group asserted that inaccuracies in credit reports

[1] For an overview of credit reporting systems around the world see the results of a recent World Bank survey as described in Margaret J. Miller (2003), pp 25-79.

could cause at least 8 million Americans to be miscategorized as subprime risks, and pay tens of thousands of dollars in excess interest payments over the term of a 30-year mortgage loan.[2]

In contrast to assertions of widespread problems in credit files, Congressional testimony also documented that the U.S. has become the world leader in competitive consumer and mortgage credit markets. In 2001, 75% of U.S. households participated in the consumer credit markets and held some type of debt. Sixty-eight percent of all U.S. households owned their homes, and nearly two-thirds of these homeowners has some type of mortgage loan. About 73% of all households owned at least one general purpose credit card (e.g., Visa, MasterCard, Discover, American Express). [3] The average U.S. consumer-borrower had 11 open credit accounts.[4] By comparison, European consumers have access to one-third less credit, as a percentage of Gross Domestic Product, than do American consumers.[5] Compared to the vast majority of other countries, U.S. creditors have managed to extend substantially more credit per capita much further down the income spectrum, at the same time maintaining relatively low delinquency rates. In the second quarter of 2000 only 2.8% of all mortgage holders in the U.S. were delinquent more than 30 days.[6] Only 4.6% of all credit card borrowers were more than thirty days delinquent on their accounts.[7] In short, Americans enjoy the remarkable combination of 1) widespread access to credit across the age and income spectrum, 2) relatively low interest rates on secured loans (e.g., home mortgages, home equity lines of credit, automobile loans), 3) exceptionally broad access to open-end, unsecured credit card products, and 4) relatively low default rates across all types of loans. It seems highly improbable that all of this could be accomplished if the underlying credit reporting system was fraught with serious errors.

In the following sections we discuss the law and economics of credit reporting in the United States. In particular, the discussion examines how the FCRA encourages accurate reporting within a voluntary system. We will sort through the available evidence on credit file quality and attempt to assess the strengths and weaknesses of the system as it functions today, as well as identify any improvements (or deterioration) in recent years. The concluding section will

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[2] See the testimony of the Executive Director of the Consumer Federation of America before the U.S. House Financial Services Committee. Brobeck (2003), p 4.

[3] Aizcorbe, Kennickell and Moore (2003), p 25.

[4] Consumer Data Industry Association, Washington DC, correspondence on file with authors.

[5] Cate, Litan, Staten and Wallison, 2003, p 12.

[6] Authors' calculations utilizing TrenData, an aggregated credit report database product of Trans Union, LLC.

[7] Ibid.

address the challenges to the regulatory framework presented by recent credit market developments such as risk-based pricing, and offer some observations about proposed solutions.

Evolution of the U.S. Credit Reporting System and Its Regulation

Emergence and Early Growth

Credit reporting evolved in the United States from the market, without assistance from the government, in response to commercial need. Credit reporting began as a product of the Industrial Revolution in the late 19th century in the United States, as it also did in Australia, Austria, Canada, Germany, Finland, Sweden, and South Africa.[8] In the United States, retailers were the primary source of consumer credit in the early 20th century. They provided 80% of consumer credit in 1919, and in 1929 credit financed one-third of all retail sales.[9] Not surprisingly, therefore, early credit bureaus in the United States were cooperatives established by local retailers to pool credit histories of their customers and to assist in debt collection.

Because credit reporting initially was linked to particular types of business, early credit bureaus specialized in providing credit reports that described customers in a particular location for a single industry segment. As a result, hundreds of small credit bureaus emerged, each focused on a particular business line in a particular geographic area. In 1906 the National Federation of Retail Credit Agencies was formed to facilitate the nationwide sharing of consumer credit information across industries. Membership in the Federation (which soon changed its name to Associated Credit Bureaus of America, then Associated Credit Bureaus, Inc., and at the end of the century to the Consumer Data Industry Association) grew from fewer than 100 bureaus in 1916 to 800 in 1927, to 1,600 by 1955.[10]

Legal and economic changes not only facilitated the growth in credit bureaus, but also increased the demand for credit, expansion in the number and variety of creditors, and the need for more and different types of credit reports. In 1916, many states relaxed their usury laws, thereby encouraging businesses other than retailers (who had effectively avoided the restraints of these laws by charging higher prices for goods bought on credit) to begin granting credit. Banks

[8] Jappelli and Pagano (2002), pp 2017-2045.
[9] Hunt (2002) pp 9-10.
[10] Ibid., p 9.

and finance companies began to provide more open-end consumer credit. As a result, the share of consumer credit held by retailers fell from 80% in 1919 to 40% in 1941, to only 5% in 2000.[11]

At the same time that sources for credit (and therefore demand for credit reports) were expanding and diversifying, the market for credit was become more national in scope. Regional and national department store chains accounted for less than 15% of department stores sales in 1929 but nearly 80% of sales by 1972.[12] The chains moved their credit operations from local stores to their national headquarters. Similarly, bank-issued credit cards, which were widely adopted in the 1960s, were serviced by national centers.

In the aftermath of World War II, the population began to expand more rapidly and to become more mobile. The pent-up demand for consumer goods—large and small—was unleashed. As a result, the demand for consumer credit escalated. Less than $6 billion of consumer credit was outstanding at the end of 1945. By 1970, consumer credit outstanding had grown to over $116 billion. Businesses and consumers both faced an increasing need for credit reports, and especially for nationwide, multi-purpose credit reports.

New technologies were beginning to make it possible to collect and store more data at less cost, and to share that information faster and more efficiently. By 1969, as Congress was debating what was to become the FCRA, there were 2,200 credit bureaus, collecting data from 400,000 creditors and public records, to maintain credit files on more than 110 million consumers.[13]

Credit Report Contents

Credit reports contained information primarily from two sources: creditors and investigators who worked for the credit bureaus. Information from creditors typically included data about credit transactions with their customers (e.g., type of credit and payment history). Creditors supplied the information voluntarily under reciprocal sharing arrangements because they needed access to similar information themselves to make credit judgments concerning their customers.

Information supplied by investigators was more diverse and ultimately proved far more controversial. This information addressed subjects including "personal character, habits and

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[11] Ibid., p 10.
[12] Ibid.
[13] *The Consumer Reporting Reform Act of 1994* (1993)

reputation . . . obtained primarily from conversations with one's neighbors, employer, landlord and fellow workers."[14] A 1962 credit report on a form supplied by the Associated Credit Bureaus of America, for example, asked these questions: "Is applicant well regarded as to character, habits and morals?" "Did you learn of any domestic difficulties?" "Does he have a reputation of living within his income?"[15] According to evidence presented to Congress in 1968 and 1969, investigators were paid on a piecework basis for this type of information, and completed their work on a file in an average of 30 minutes.[16]

This type of information not only had the potential to intrude significantly on personal privacy, it was also highly impressionistic and therefore subject to considerable inaccuracy. Credit bureaus typically did not undertake any independent investigation of information obtained from either creditors or investigators. Neither did most users of credit reports. As one contemporaneous commentator noted: "The typical credit investigation is not conducted in a manner that compels confidence in the report."[17] Moreover, reports were often provided orally over the telephone, which further increased the chance for error and decreased the ability of anyone to go back later and discern what was included in the original report or whether it was accurate.

Most credit bureaus supplied reports to anyone who asked and was willing to pay for them, except for individuals who sought access to records about themselves. Credit bureaus steadfastly refused such requests and, in fact, included nondisclosure language in their contracts with regular commercial subscribers to prevent disclosure of credit report information to consumers. As a result, not only did consumers not have the chance to dispute the accuracy of information in their own credit reports, many did not even know of their existence.

Accuracy Incentives

Credit bureaus had market-driven incentives to provide accurate information. Inaccurate information was inherently less valuable to the bureaus' customers, the creditors who wished to avoid making loans to people who were unlikely to repay, but also wished to accommodate potentially profitable customers who needed credit. Moreover, as credit bureaus expanded their

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[14] *Protecting the Subjects of Credit Reports* (1971)
[15] Karst (1966) pp 342, 372.
[16] *Hearings on Commercial Credit Bureaus Before a Subcomm. on Invasion of Privacy of the House Comm.. on Government Operations* (1968), pp 67, 88; 115 Congressional Record (1969), pp 2410, 2413.
[17] *Protecting the Subjects of Credit Reports* (1971), p 1036.

geographic and product scope, they were more likely to face competition from other bureaus; one basis on which bureaus could compete was the accuracy of their reports.

But other incentives that might have provided a more powerful inducement to provide only accurate information were missing, and the incentives that did exist were offset by other concerns. For example, the pressure from creditors to provide accurate credit reports did not apply evenly. On a marginal loan, creditors faced higher costs from providing credit to the "wrong" person than from denying credit to the "right" person. Therefore, credit bureaus were more likely to receive and retain *derogatory* information in an individual's file (e.g., delinquency or default) than *positive* information about accounts successfully paid.

The most obvious counterincentive to the pressures to retain derogatory information, even if inaccurate, would be pressure from consumers anxious to have their reports reflect the most positive picture possible. That pressure was wholly missing, however, because individual consumers were unable to access their credit reports and many were unaware of their existence. Moreover, in the days before the development and adoption of statistical risk scoring models, it was much more difficult for creditors to identify in any systematic way that there were problems with the quality of data supplied by credit bureaus.

Significantly, there was virtually no legal regulation of credit reporting during its evolution in the United States. Until 1970, there was no federal statute and only one state (Oklahoma[18]) had a law that constrained the compilation or use of reports. Common law remedies were unavailable, in large part because every state (except for Georgia and Idaho) recognized a common law privilege that protected credit bureaus from defamation actions unless the plaintiff could prove that the bureau intended to cause harm.[19] Other actions—for example, for products liability or fraud—were foreclosed to consumers in most states because of elements of the action that could not be shown in credit reporting.[20]

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[18] See Oklahoma Statutes title 24, § 81085 (enacted in 1910). Five other states adopted legislation contemporaneously with the FCRA. See McNamara (1973), p 72, n.24.

[19] *Protecting the Subjects of Credit Reports* (1971), pp 1050-51 and sources cited therein.

[20] "Liability for Misstatements by Credit-Rating Agencies (1957): 561; *Protecting the Subjects of Credit Reports* (1971), pp 1054-1061.

The Fair Credit Reporting Act of 1970

Legislative History

Congress first became interested in the regulation of credit files in the 1960s, after a series of study commissions examining proposals for a federal government data bank about citizens raised issues about similar files maintained by private firms in the credit reporting industry. Legislative hearings began in 1968 and focused attention on the existence of comprehensive credit reports and the lack of government regulation or oversight.[21] The resulting publicity, the hearings themselves, and a spate of articles in major national publications brought forward hundreds of anecdotes about consumers being denied credit because of inaccurate information in credit reports or otherwise being treated unfairly by creditors and credit bureaus.

The most emotion-laden aspects of the hearings involved the segment of the consumer reporting industry that produced investigative reports. Such reports were subjective evaluations of a person's character and lifestyle. Hired investigators would compile reports in the field, or over the phone, through personal interviews of friends and neighbors of the subject. As noted, because of the manner in which the reports were compiled and the fact that they were inherently subjective, their accuracy was suspect. The reporting bureaus cloaked the investigative process and even the existence of consumer files in secrecy, refusing to divulge not only the contents, but even the sources, of information to consumers.

Transaction-based credit reports received their share of criticism. The hearings cited accuracy problems related to creditors reporting inaccurate information, bureaus merging one person's data with another person's file, incomplete or missing information, and data entry errors.[22] Testimony focused on the absence of legal incentives for accuracy, as well as the significant impediments to consumers learning what was on their credit reports. This perceived veil of secrecy encouraged Congress to lump credit reporting together with investigative reporting, to be regulated with one piece of legislation.

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[21] McNamara (1973), pp 67, 72-76.

[22] Senator William Proxmire, who introduced the bill that later became the Fair Credit Reporting Act, gave the following justification for the bill on the Senate floor in 1969: "First, the problem of inaccurate or misleading information; second, the problem of irrelevant information; and, third, the problem of confidentiality." He identified the most serious problem as inaccurate or misleading information. Conceding that "it is unrealistic to expect 100 percent accuracy," he concluded that the prevailing level of inaccuracy was intolerable. Congressional Record, U.S. Senate, January 31, 1969.

Ultimately, three broad themes came to dominate the legislative debate: fairness, accuracy, and privacy. Congress responded by adopting the Fair Credit Reporting Act, which it passed in amended form on October 26, 1970, and which took effect in April 1971.[23]

The Act's Requirements

Given the intense and emotional legislative atmosphere, the FCRA was a notably moderate attempt to enhance fairness, accuracy, and privacy, while not undermining the competitive credit reporting system itself. In its "findings" in the preamble to the Act, Congress highlighted the delicate balance it was trying to craft: "The banking system is dependent upon fair and accurate credit reporting. Inaccurate credit reports directly impair the efficiency of the banking system, and unfair credit reporting methods undermine the public confidence which is essential to the continued functioning of the banking system. . . . There is a need to ensure that consumer reporting agencies exercise their grave responsibilities with fairness, impartiality, and a respect for the consumer's privacy."[24] Congress went on to make clear: "It is the purpose of this title to require that consumer reporting agencies adopt reasonable procedures for meeting the needs of commerce for consumer credit, personnel, insurance and other information in a manner which is fair and equitable to the consumer, with regard to the confidentiality, accuracy, relevancy, and proper utilization of such information in accordance with the requirements of this title."[25]

The law permitted credit bureaus to assemble credit reports freely. It defined a consumer report as:

1. Any written or oral communication of information by a consumer reporting agency (see below);
2. That bears on a "consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living";

[23] Fair Credit Reporting Act of 1970, Pub. L. No. 91-508, 84 Stat. 1114 (codified at 15 U.S.C. §§ 1681-1681t).
[24] 15 U.S.C. § 1681(a).
[25] Ibid., § 1681(b).

3. That is used or expected to be used as a factor in establishing the consumer's eligibility for consumer credit or insurance for "personal, family or household purposes," employment, or other "permissible purposes" (see below).[26]

The term "consumer report" does not include reports containing information:

1. "solely as to transactions or experiences between the consumer and the person making the report";
2. Authorizations or approvals of specific extensions of credit by issuers of credit cards or a "similar device"; or
3. Offers of credit requested by third parties, provided that "the third party advises the consumer of the name and address of the person to whom the request was made" and otherwise complies with the requirements applicable to "adverse actions".[27]

The 1970 FCRA applied only to individuals (not entities) and only to consumer (not business or commercial) credit or insurance. Moreover, information that has no bearing on a "consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living," even if contained in a consumer report, is not regulated by the FCRA. With the exception of procedures to be followed in the event of a creditor taking "adverse action" based on a credit report and restrictions on the creation and use of "investigative consumer reports" (see below), the law applied only to consumer reporting agencies.

The Act defined "consumer reporting agency" to mean "[a]ny person which, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties, and which uses any means or facility of interstate commerce for the purpose of preparing or furnishing consumer reports."[28] This definition included not only recognized credit bureaus, but also anyone who regularly furnishes information beyond its own transactions or experiences with consumers to

[26] Ibid., § 1681a(d).
[27] Ibid., § 1681a(d)(2).
[28] Ibid., § 1681a(f). Hereafter, we will use the terms consumer reporting agency and credit bureau interchangeably.

third parties for use in consumer transactions.[29] The FCRA imposed no limit on other non-consumer reporting-related activities in which an agency may engage.

The FCRA also introduced the concept of an "investigative consumer report," which it defined to mean any portion of a consumer report in which information on a consumer's "character, general reputation, personal characteristics, or mode of living is obtained through personal interviews with neighbors, friends, or associates of the consumer" or others, other than factual information obtained directly from a creditor or from a credit report if the bureau obtained the information directly from a creditor.[30]

The FCRA treated investigative consumer reports differently from regular consumer reports. Investigative consumer reports may only be procured or prepared if the consumer reporting agency first informs the consumer in writing of its intention to do so, and of the consumer's right to receive, upon request, a "complete and accurate disclosure of the nature and scope of the investigation" to be conducted; or if the report is to be used for employment purposes only.[31]

The FCRA limited the disclosure of certain information deemed by the statute as "obsolete." For example, most negative information on the credit file (e.g., delinquencies, charged-off accounts, collection judgments) was permitted to reside on the file no longer than seven years. Bankruptcy information could remain on the file for 14 years (later reduced to 10 years).[32] This provision was perceived as an important component for achieving the stated goal of "fairness" in credit reporting, although it also clearly affected the accuracy of the credit profile. The limits on investigative reports and the provisions for ensuring that consumers had access to their credit reports (see below) also advanced the fairness goal.

Accuracy Incentives

The FCRA promoted accuracy in credit reporting primarily through four provisions. First, the Act required credit bureaus to follow "reasonable procedures to assure maximum possible accuracy" of the information in their credit reports.[33]

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[29] 16 C.F.R. pt. 600 App.
[30] 15 U.S.C. § 1681a.
[31] Ibid., § 1681d.
[32] Ibid., § 1681c.
[33] 15 U.S.C. § 1681e(b).

Second, it required credit bureaus to provide consumers with a copy of their reports, and a list of recipients of those reports during the past six months, upon request.[34] Bureaus were also required to provide "trained personnel to explain to the consumer any information furnished to him." Bureaus were permitted to impose a "reasonable charge" for access in most cases.

Third, users of credit reports that denied credit, insurance, or employment, or imposed a higher charge for credit or insurance, because of information contained in a credit report must inform the consumer of this fact and supply the consumer with the name and address of the credit bureau that supplied the report.[35] If the consumer contacts the credit bureau within 30 days after receiving the "adverse action" notice, the FCRA provided that the bureau must supply the consumer with a free copy of his or her credit report.[36]

Fourth, the law required credit bureaus to implement a dispute resolution process to investigate and correct errors. Bureaus were to delete any disputed data that they could not verify within a "reasonable period of time." If the bureau determined that the information was accurate, but the consumer disagreed, the law requires the bureau to include a statement from the consumer of not more than 100 words, or a summary of that statement, with future credit reports that contain the disputed data. In either case, the bureau must notify the consumer "clearly and conspicuously" that the consumer may direct that the bureau to inform persons who received the report during the past six months that the data have been deleted or disputed. [37]

Taken together, these four provisions were intended to make the credit reporting system more transparent and to empower consumers to help make their own credit reports more accurate.

The 1970 Act provided for civil liability through actions brought by the Federal Trade Commission, other federal regulators, and individual consumers.[38] The Act extended substantial protection to credit bureaus, however, through provisions requiring only "reasonable procedures"[39] and restricting defamation actions against credit bureaus for the content of their reports unless the plaintiff could show "malice or willful intent to injure such consumer."[40] The

[34] Ibid., § 1681m. The disclosure must include recipients of files that had been used for employment purposes for the past two years.
[35] Ibid., § 1681m.
[36] Ibid., § 1681j.
[37] Ibid., § 1681i.
[38] Ibid., §§ 1681n-1681o, 1681s.
[39] Ibid., § 1681m.
[40] Ibid., § 1681h.

FCRA also permitted states to enact credit reporting laws of their own, provided that they were not inconsistent with the Act.[41]

Credit Reporting Under the 1970 version of the FCRA

The FCRA took effect in 1971 and for the following 25 years regulated credit reporting with only minor amendments. By permitting the collection and centralized storage of data about an individual's creditworthiness, but imposing limits on its use, the Act created a flexible and largely self-enforcing regulation that proved workable despite dramatic changes in technologies, markets, and uses for credit report information, as well as the structure of the reporting industry itself.[42]

Through the adoption of computerized storage systems and subsequent advances in data processing technology, local credit bureaus, which provided information only in the town or region where they did business, expanded the process of linking the data they held. The trend toward nationwide credit markets and the subsequent need for linked credit reporting became so powerful that by the early 1990s the many local credit bureaus had evolved into essentially three national automated reporting systems—Equifax, Experian, and TransUnion.

This automated centralization of credit files, together with the capital required for automation, caused many local bureaus to close or be absorbed into the national system. Membership in the ACB declined from a peak of 2,200 in 1965 to fewer than 1,000 by 1996.[43] Over the same period the demand for credit reports increased dramatically, as did the amount of credit held by individual consumers.

By the late 1980s, the growth and national scope of credit marketing, coupled with new uses for credit reports and greater consumer awareness of the importance of credit reports, raised new concerns about credit reporting. In particular, five issues seemed to dominate the debate: (1) the use of credit reports for "pre-screening" consumers to determine which were most likely to be eligible for an offer of a credit card, second mortgage, loan, or other offer of credit or insurance; (2) the extent to which information about transactions with customers could be shared among affiliates without meeting the requirements of the FCRA; (3) the privacy implications of the permissible uses of credit reports, particularly in connection with new uses like pre-

[41] Ibid., § 1681t.
[42] The FCRA did have the benefit of frequent FTC rule-writing and clarification.
[43] Hunt (2002), p 11.

screening; (4) the accuracy of credit reports; and (5) allegations of lack of responsiveness by the credit bureaus to consumer requests and concerns. These concerns grew through the early 1990s. In addition, by the mid-1990s credit bureaus and credit grantors worried that a growing number of state-level credit reporting and privacy laws were beginning to threaten the efficiency and cost-effectiveness of the national credit reporting system.

1996 FCRA Amendments

Congress began considering amendments to the FCRA in March 1990, but it took six and one-half years before it finally adopted the Consumer Credit Reporting Reform Act as part of a bank regulatory relief package in September 1996.[44] The 1996 Act addressed each of the five areas of concern. For example, it expressly authorized "prescreening" of credit report information for the purpose of marketing credit or insurance opportunities to consumers, but on the condition that credit bureaus establish and publish a toll-free telephone number that consumers can call to have their names removed from lists provided for such direct marketing purposes.[45] The law also authorized the sharing of consumer report information among affiliated companies, provided that the consumer is given an opportunity to "opt out" of that sharing.[46] These and other changes reflected an effort to balance privacy concerns with new uses of credit reports, by conditioning authorization of those uses on the creation of new opportunities for consumers to restrict them.

The Act enhanced consumer control—and with it, both fairness and privacy—in other important ways. For example, the Reform Act narrowed the broad "legitimate business need" purpose for which credit reports could be disseminated to permit the distribution of credit reports only for a "business transaction that is initiated by the consumer" or "to review an account to determine whether the consumer continues to meet the terms of the account."[47] The Act provided that consumer credit reports could be furnished for employment purposes only if the employer certifies that the employee has consented in writing.[48] The Act prohibited the inclusion of medical information in a credit report furnished in connection with employment, credit,

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[44] Consumer Credit Reporting Reform Act of 1996 (1996), §§ 2401-2422. The legislative history of the 1996 amendments is documented in Seidel (1998).
[45] 15 U.S.C. § 1681b(c)(5).
[46] Ibid., § 1681a(d)(2)(A)(iii).
[47] Ibid., § 1681b(a)(3)(F).
[48] Ibid., § 1681b(b).

insurance, or direct marketing, without the consent of the consumer.[49] The Act permitted the dissemination of obsolete information only in connection with an employment application for a position with a salary over $75,000, a credit transaction over $150,000, or the underwriting of life insurance over $150,000, thus substantially raising these thresholds from their 1970 levels.[50] And it regulated resellers of credit reports to require that they disclose the end-user of the report and the permissible purposes for which the report will be furnished.[51]

The most significant changes the 1996 Reform Act made to the FCRA were designed to enhance the accuracy of credit reports, primarily by expanding the practical and legal ability of consumers to access, dispute, and obtain correction of their credit reports. The law expanded access by consumers to their credit reports. It required credit bureaus to disclose "[a]ll information in the consumer's file," other than credit scores, to any consumer requesting access. This is a noteworthy change from the 1970 FCRA, which required disclosure of only the "nature," "substance," "sources," and "recipients" of the report. In addition, the 1996 Act required the disclosure of not only the identity of recent recipients of a consumer report, but also, upon request of the consumer, the address and telephone number of each as well.[52] The law also specified in detail the information on consumers' legal rights under federal and state law that credit bureaus must disclose to any consumers seeking access to their credit reports, and required the bureaus to develop a form "for the purpose of maximizing the comprehensibility and standardization" of that disclosure.[53]

The law expanded the conditions under which consumers are entitled to receive free access to their credit reports by providing an expansive definition of "adverse action,"[54] extending (from 30 to 60 days) the time after consumers receive notice of adverse action that they can request their credit reports,[55] and by allowing consumers to obtain a free credit report once every year if they are unemployed and intend to apply for employment, recipients of public welfare assistance, or have "reason to believe" that their credit reports "contains inaccurate information due to fraud."[56] The 1996 Act also provided that the fee credit bureaus charge

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[49] Ibid., § 1681b(g).
[50] Ibid., § 1681c(b).
[51] Ibid., § 1681e(e).
[52] Ibid., § 1681g(a).
[53] Ibid., §§ 1681g(c), (e).
[54] Ibid., § 1681a(k).
[55] Ibid., § 1681j(b).
[56] Ibid., § 1681j.

individuals to access their own credit reports, in those situations in which the bureau is permitted to charge a fee, may not exceed $8.00, which the FTC may adjust upwards only as necessary to keep pace with the Consumer Price Index.[57]

The Act gave consumers greater power to challenge and correct erroneous information in their credit reports. It required credit reporting agencies to delete any disputed data that they cannot verify within 30 days, as well as comply with a variety of new procedural requirements intended to ensure that inaccurate data are deleted or corrected and that inaccuracies do not reoccur in future credit reports.[58]

The 1996 Act expanded the legal obligations of users of credit reports and, for the first time, imposed obligations on furnishers of credit information. It required users to notify consumers of adverse action taken on the basis of consumer report information and of their legal rights, including the right to receive a copy of the report and to dispute its accuracy or completeness.[59]

The Act prohibited furnishers of credit information from furnishing any data to consumer reporting agencies that is known to be inaccurate.[60] If the consumer has disputed the information, the furnisher must inform the credit reporting agency of the existence of the dispute.[61] The Act required furnishers of disputed information to reinvestigate the accuracy and completeness of the information and report back to the consumer reporting agency and, in some instances, to all consumer reporting agencies to which they had furnished the disputed information.[62] Entities that "regularly and in the ordinary course of business" provide information to consumer reporting agencies must correct information previously submitted to a consumer reporting agency and subsequently determined to be inaccurate, and must not furnish that information again until it is accurate and complete.[63]

The Act also required regular furnishers to provide notice to credit bureaus when consumers voluntarily close credit accounts.[64] If a credit bureau is notified that a credit account was voluntarily closed by the consumer or that information reported to the bureau by a furnisher

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[57] Ibid., § 1681j(a).
[58] Ibid., § 1681i(a).
[59] Ibid., § 1681m.
[60] Ibid., § 1681s(a)(1).
[61] Ibid., § 1681s(a)(3).
[62] Ibid., § 1681s(b).
[63] Ibid., § 1681s(a)(2).
[64] Ibid., § 1681s(a)(4).

is disputed by the consumer, the bureau is required to indicate that fact in future credit reports.[65] All furnishers that report delinquent accounts as "being placed for collection, charged to profit or loss, or subject to any similar action" must, within 90 days, notify credit bureaus of the "month and year of the commencement of the delinquency that immediately preceded the action."[66]

The 1996 Act authorized states to enforce the FCRA,[67] but then, recognizing the inherently national nature of credit markets and credit reporting, Congress preempted the states from enacting laws or regulations dealing with the subject of the 1996 amendments. Preemption of state laws was viewed as necessary to prevent disparate or conflicting state rules from triggering a decline in voluntary reporting, erosion in credit file content and quality, and a reversal of the development of competitive national markets for credit, insurance and other financial services. Specifically, the 1996 amendments prohibited state laws dealing with:

1. Information-sharing among affiliates (except for two provisions of Vermont law[68]);
2. Prescreening;
3. Notices to be included with prescreened solicitations;
4. Summary of consumer rights to be provided to individuals;
5. Responsibilities of persons who take adverse action based on a credit report.
6. Time to complete reinvestigations;
7. Furnisher responsibilities (except for provisions of California[69] and Massachusetts law[70]); and
8. Time periods for determining the obsolescence of information in consumer credit reports.[71]

Given the dramatic changes that were taking place in technologies, credit, and the uses of credit reports, Congress built into the statute an opportunity to revisit its performance by providing that these preemption provisions would expire on January 1, 2004.[72]

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[65] Ibid., §§ 1681c(e)-(f).
[66] Ibid., § 1681s(a)(5).
[67] Ibid., § 1681s(c).
[68] Vermont Stat. Ann., tit. 9, §§ 2480e(a), 2840e(c)(1).
[69] Cal. Civ. Code § 1785.25(a).
[70] Mass. Gen. Laws Ann. ch. 93, § 54A(a).
[71] 15 U.S.C. § 1681t.
[72] Ibid., § 1681t(b)(1)(C).

What is an Accurate Credit Report?

A review of various reports and studies that examine credit report accuracy reveals that at the heart of conflicting assessments of how well the U.S. credit reporting system is doing under the FCRA are fundamental differences in the interpretation of "accuracy."[73] Accuracy is a stated goal of the reporting system, but exactly what is an accurate credit report?

The FCRA itself is not clear on this point. It states that consumer reporting agencies must "follow reasonable procedures to assure maximum possible accuracy."[74] Accuracy is not defined, nor is it clear what we should expect about the quality of credit files once the upper limits of "reasonable" procedures are reached.

During Congressional testimony in 1991, the president of Associated Credit Bureaus — the credit reporting industry's primary trade association — offered a useful insight that provides a metric for assessing accuracy. He remarked that "the mission of the consumer reporting industry is to serve as an objective third-party provider of information to the companies and consumers involved in credit transactions. Our members are libraries that make it possible for credit grantors to provide consumers with the opportunities they seek."[75] Ultimately, this general statement may be the key to judging the accuracy of files. The question of well the reporting system is performing turns on the issue of whether credit files contain sufficient information to allow creditors and other authorized users to assess the eligibility of consumers for the services they seek.

Files can contain factual errors (e.g., misspelled name; incorrect old address; misspelled current street, etc.), but still be accurate representations of a consumer's credit history. Conversely, files can be factually correct but not an accurate representation of a consumer's credit history because of missing accounts, accounts listed as open but that are long inactive, or old derogatory information that has been rolled off the file. And files may—in fact, almost always do— contain stale or outdated information (e.g., outstanding balances that are 30-60 days old, etc). Most stale information was accurate at the time it was submitted, but with continued

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[73] In its 2003 report to Congress on credit report accuracy, the U.S. General Accounting Office found that the "available literature and the credit reporting industry strongly disagree about the frequency of errors in consumer credit reports, and lack a common definition for 'inaccuracy.'" U.S. General Accounting Office (2003), Executive Summary.
[74] Ibid., § 1681e(b).
[75] *Fair Credit Reporting Act,* Hearing (1991), pp 98-100.

activity on an account (charge activity, payments), the information can become outdated very quickly.

Further reflection suggests that the degree of accuracy of a credit file is entirely dependent on the purpose to which the information will be put. All the information in a file may be factually correct, but the file might be missing key pieces of information about a consumer's past or current credit experience that are important for predicting the consumer's future behavior, rendering the file of little value. Arguably, for millions of consumers in the U.S., conventional credit files are missing entire categories of relevant information, such as a history of rent or utility payments. For these people, the files are not accurate representations of the existing information that is helpful for predicting future payment risk.

Complicating the goal of achieving a higher degree of accuracy in credit files is the fact that we sometimes intentionally compromise accuracy in the files. For example, the FCRA limits the reporting of old derogatory information as part of a consumer's credit profile. Specifically, old derogatory information (e.g., delinquencies, chargeoffs, repossessions, collection activity) can not be reported after 7 years (10 years for personal bankruptcy).[76] So some degree of inaccuracy is mandatory under the FCRA.

So it seems that the accuracy of a given credit file is partly dependent on what is in the file, partly dependent on what is missing from the file and partly dependent on the use to which the information will be put. Credit file "quality" may be a better term for assessing how well the FCRA performs in facilitating opportunities for consumers, where "quality" refers to the predictive value of information contained in the file. The significance of these distinctions will become apparent in the following sections, which examine how the FCRA is structured to promote accuracy and assess the law's effectiveness.

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[76] This mandatory "fresh start" serves a useful purpose. If delinquency and other derogatory information could stay on a credit file for very long periods (or even permanently), it could make borrowers overly cautious, reduce the use of credit, and diminish the efficiency with which consumers can smooth consumption over time to match uneven income streams. In addition, if a consumer does becomes delinquent and gets on a permanent black list, the reporting of such information can reduce the incentive to repay ("in for a penny, in for a pound"). But, paradoxically, if the roll-off time is too short, it also reduces the incentive for good payment, by reducing the cost to the borrower of becoming delinquent. Consequently, there is conceptually an optimum roll-off time for derogatory information. More information is not always better. There is a tradeoff between borrower discipline and the restorative effects of the second chance. For a more rigorous theoretical development of these ideas see Vercammen (1995) and Padilla and Pagano (2000).

FCRA and the Production of Accurate Credit Files

To understand how the regulatory approach adopted in the FCRA promotes the assembly of credit files that are both "accurate" and "relevant" within a voluntary reporting system, it is helpful to think of credit reporting as a problem of information production. For example, in the context of loan decisions, creditors (and consequently credit bureaus) wish to acquire better information about borrowers so long as the extra value (from better risk assessment) exceeds the extra cost.[77]

Constraints that affect any system for producing credit history information (voluntary or compulsory) include the following:

1. ***Accuracy is costly***. The cost of producing a credit file rises with the level of accuracy (e.g., factual accuracy of contents; frequency of data updates; completeness of the consumer's current credit usage profile; depth of historical detail; inclusion of all relevant information useful for assessing credit risk).
2. ***The consumer is in the best position to know*** when a credit file is accurate and complete, across all trade lines. But, the consumer also has an incentive to portray his/her credit history more favorably in order to obtain credit (the problem of moral hazard). So, creditors must verify the credit history from an independent source.
3. ***By specializing in central storage of credit histories, a credit bureau can produce accurate reports at lower cost than individual lenders.*** A centralized data warehouse is less expensive to operate compared to a system in which each potential creditor contacts other creditors with each new application, duplicating each other's storage efforts. Bulk transmittal to a bureau of one month's credit experience for all its accounts is cheaper for a creditor than making and responding to multiple calls on behalf of its customers who are making applications elsewhere.
4. ***The market will reward the production of accurate files.*** A credit bureau's customers will pay more for accurate reports (or buy them more frequently), and pay less as accuracy declines. Self-interest on the part of wealth maximizing credit bureaus in a

[77] It follows that credit file information has value only to the extent that it improves risk prediction. This principle helps to explain what types of data are included in credit bureau files, and how file content will change over time with the evolution of more sophisticated risk management tools and applications. Some items gain in importance while others decline, perhaps to the point that they are no longer worth updating.

competitive reporting environment creates a powerful force for improving the quality of files.[78]

An important problem hinders the construction of accurate credit histories under any system. Neither the credit bureau nor the purchaser of a credit report (the credit grantor) can easily judge the accuracy of a consumer's credit file. The creditor only knows its own experience with a customer. The bureau only knows what creditors tell it. Mistakes can be made by either party in data transmittal and file assembly. The consumer knows his/her complete credit history, but has some incentive to misrepresent it out of self-interest.

Given the extensive, voluntary reporting system that had already evolved in the United States in the absence of federal regulation, two fundamentally different regulatory avenues were available to incorporate into the FCRA to promote accuracy, the ***preventive approach*** and the ***remedial approach.*** By taking the "preventive approach," Congress could have authorized specific and mandatory procedures (either directly within the language of the FCRA or indirectly by granting rule-writing authority to a federal agency such as the Federal Trade Commission) for submitting, verifying, matching and re-investigating information on the credit files. In essence, the regulators would stipulate how to run the credit reporting process. Alternatively, the FCRA adopted a "remedial approach" which harnessed the incentives for producing accurate reports inherent in a competitive credit reporting market, but also established an error detection and correction mechanism ***initiated by the consumer.*** Consumers would be permitted (and encouraged) to monitor their own files, and to dispute items perceived to be incorrect.

The preventive and remedial approaches differ in their impact on the costs of producing accurate credit files. Arguably, the FCRA incorporates the least costly means of utilizing the comparative advantage in the production process of each of the system's participants' to improve the accuracy of the end-product.

An analogy to other industries helps to illustrate the difference between the two approaches. Manufacturers of complex consumer goods such as automobiles, computers and home electronic equipment face similar quality control problems. For these items, it is expensive

[78] To reiterate a point made above, competitive market forces give the bureaus an incentive to improve the quality of information that is predictive of risk. This gives focus to their efforts and affects the resulting content of the file. So, for example, bureaus will not devote effort to update information contained in credit files that creditors once found helpful but no longer utilize (e.g., place of employment). The quality of the file for assessing borrower risk does not suffer, even as some of the information contained in the file becomes outdated.

for both producers and consumers to detect all errors or defects prior to purchase. Many potential defects are either so easy to spot or have such serious implications for the end-user (and the manufacturer's brand reputation) that the manufacturer invests in processes to detect them before the item is sold. But, with complex goods, some defects will remain. Of course, a new computer will be inspected on an ongoing basis after the sale by the customer who purchases and uses it. So, instead of going to the expense of inspecting the computer for all defects **twice** (once by the producer on the assembly line and once by the consumer as it is used), computer manufacturers shift some of the inspection duties onto the consumer, and promise to repair or replace defective products. The ***product warranty*** effectively designates the consumer as a quality-control inspector. Consequently, the manufacturer incurs lower costs of production (relative to more rigorous inspection on the assembly line), the product price is lower, customers incur lower search costs prior to purchase since they have the assurance that they can return defective merchandise, and everyone enjoys greater gains from trade.[79]

The remedial approach taken by the FCRA resembles the extension of a product warranty (although for credit reports the warranty is mandated by the law). As noted above, the consumer is the only person who knows the true credit history which the credit file attempts to describe. Essentially, the FCRA designates the consumer as the "quality-control" inspector with the authority to mandate reinvestigation (and alert potential purchasers) of credit information when errors are detected. By doing so it places the responsibility for monitoring file accuracy on the party who can determine accuracy at the lowest cost. [80]

It would be incorrect to conclude that the FCRA's remedial approach leaves the credit bureau with no incentive to ***prevent*** errors. Although there is no explicit dollar fine imposed when a consumer detects an error, the mandatory re-verification process is costly for both bureaus and creditors.[81] Like the automaker who must reimburse dealers for warranty work to

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[79] For a more detailed discussion of how the transaction costs associated with measuring quality influence the organization of markets see Barzel (1982).

[80] It is clear from 30 years of commentary on the FCRA that the Federal Trade Commission has long recognized the important role and responsibility that consumers play in facilitating the system's production of accurate credit reports. For example, see the testimony of Jeanne Noonan, Associate Director for Credit Practices at the Federal Trade Commission, *Fair Credit Reporting Act, Hearing* (1991), p 39.

[81] All parties share in the costs of preventing and detecting reporting errors. The remedial approach imposes some additional costs on the consumer as well, most notably in the event that an erroneous credit report leads to rejection for credit, insurance or employment. The FCRA gives consumers the opportunity to avoid the higher cost of rejection by purchasing and reviewing a copy of their credit report, at any time, as a *preventive* measure. The 1996 FCRA amendments placed a ceiling of $8 on the price bureaus could charge consumers for a copy of their credit

repair defective vehicles, both creditors and the bureaus would like to reduce the costs they will be required to incur if a consumer finds an error. They will invest in reporting and updating procedures that eliminate most errors. Bureaus have an additional, powerful incentive to invest in procedures that eliminate problems in matching new information to files: the creditors are their customers and they pay for accuracy. A bureau with a reputation for file errors will suffer lost sales in a competitive market for credit reports as creditors shift their business to vendors that establish a reputation for greater reliability.

However, notwithstanding the oft-repeated goal of error-free reports, the reality of matching over 2 billion trade line updates, 2 million public record items and an average of 1.2 million changes of household address, from 30,000 different furnishers, to the proper consumer files *each month* is that the resulting files will still contain some errors, although the bureau will not know their location.[82] At some achieved degree of accuracy, it becomes cheaper to correct the error the consumer finds rather than adopt procedures that would scrutinize every item in every file in an attempt to detect potential errors prior to release. By assigning consumers the legal role of quality inspector, the FCRA reinforces the financial incentive for bureaus to invest in accurate reporting and prevent those errors for which it has a comparative advantage.

If the law required bureaus to eliminate those errors entirely—(i.e., to rely exclusively on the preventive approach)—it would make the system substantially more expensive to maintain and operate, with negative implications for the price and availability of credit and related products. The FCRA's reliance on the remedial approach instead of the more expensive

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report. Many financial counselors advise consumers to inspect their credit files prior to a major purchase, such as a home or automobile, in order to detect problems in advance of an application. Responding to swelling consumer interest in detecting fraud and preserving the integrity of their credit files, by 2002 all three of the major U.S. repositories (Equifax, Experian and Trans Union) were offering services to consumers who wished to monitor their credit files on a regular basis. Consumers who place a lower value on the content of the file (perhaps because they do not anticipate a transaction that would require a credit report) can choose not to incur the cost of checking their file. For all consumers, the FCRA mandates a "quality alert" notice in the form of an adverse-action notice sent to consumers whenever information in the credit report has contributed to a negative decision on an application for credit, insurance, apartment rental or other credit-related products. This provides additional impetus to check the file. The FCRA also explicitly recognizes that some types of errors may be more costly to the consumer than others. For example, while the FCRA applies a strictly remedial approach to reports used for credit or insurance applications, it incorporates a more preventive approach if a report is requested by a potential employer. If a report for delivery to an employer has any (negative) public record items, the FCRA requires the credit bureau to notify the consumer that such information is being reported, or to take extra steps to ensure the accuracy of the information prior to reporting it. CDIA officials have indicated that bureaus have adapted to this requirement by not including derogatory public record information in employment reports.

[82] Consumer Data Industry Association, letter to the National Center for State Courts, April 18, 2002, on file with the authors.

preventive approach is yet another example of the careful balance struck in the statute in the interest of expanding consumer credit opportunities.

How Effectively Does the Existing FCRA Promote File Quality?

As noted in the previous sections, credit file "errors" have concerned policymakers and consumers for the past 30 years. Yet, reliable measures of credit file accuracy are surprisingly scarce. Simple barometers of the performance of the credit reporting system can be misleading. For example, the number of complaints received by the FTC involving consumer reporting agencies (i.e., credit bureaus) grew from 1,300 in 1997 to nearly 12,000 in 2002.[83] However, the FTC has stated that it could not determine how many complaints involved alleged errors in reports (vs. other issues such as CRA conduct). Furthermore, the FTC staff has cautioned that it should not be inferred that an increased volume of complaints indicates a rise in errors, since the former could be due to greater consumer awareness of the FTC's role with respect to credit reporting and rising general awareness of the existence and importance of credit reporting and scoring.

At the request of Congress, the U.S. General Accounting Office (GAO) undertook a review during 2003 of available studies and databases to determine the frequency, type and cause of credit report errors. It concluded that "the lack of comprehensive information regarding the accuracy of consumer credit reports inhibits any meaningful discussion of what more could or should be done to improve credit report accuracy. Available studies suggest that accuracy could be a problem, but no study has been performed that is representative of the universe of credit reports."[84] After reviewing the available evidence, we agree.

Inaccuracies can turn up in credit files in many ways. At the risk of oversimplifying, consider two categories of file inaccuracies or "errors." *Errors of commission* consist of items or events included in the file that should not be there (e.g., accounts and public record items that do not belong to the borrower, or delinquencies that never occurred). For most consumers, "errors in credit reports" probably connotes an image of errors of commission. This is especially true for victims of mismatched files, or identity theft. In contrast, *errors of omission* are items or events associated with the consumer that do not appear in the file, e.g., existing but un-reported

[83] Statement of Richard J. Hillman, U.S. General Accounting Office (2003), p 15-16.
[84] Statement of Richard J. Hillman, U.S. General Accounting Office (2003), p 17.

accounts, missing balances or credit limits, and records of prior payment history on accounts, both positive and negative. Both types of errors reduce file accuracy, and may or may not reduce a file's quality in terms of its value for assessing risk.

Most of the limited evidence available on credit file accuracy that is statistically representative consists of studies of file inconsistencies. Such studies pose fewer methodological obstacles for researchers because they do not require the consumer's participation. It is much easier to identify information in a single credit file that is either missing or inconsistent with other information in the file, or is inconsistent with a credit file on the same consumer from another bureau, than it is to determine whether a specific item in the file is correct. Below we review available data from both types of studies.

Federal Reserve Board, 2003

A 2003 report from the research staff at the Federal Reserve Board (FRB) examined a large, nationally representative random sample of individual credit reports supplied by one of the three major credit repositories.[85] The purpose of the study was to assess the suitability of credit bureau data as a source of detailed and timely information, at the regional or national level, on consumer debt status, loan payment behavior and overall credit quality. Specifically, the researchers examined the detailed (anonymous) credit files for a nationally representative sample of 248,000 consumers as of June, 1999. Each record contained approximately 350 variables that described credit usage and performance. In total, the sample contained information on 2.58 million accounts, from more than 23,000 furnishers of information. The authors note that the sample is somewhat dated, so that the findings may not reflect current circumstances or trends in the reporting industry.

Because the study design did not involve consumers in the assessment of the file content, the analysis generally can't identify whether any particular item in a file was erroneous, (i.e., a delinquency appearing on an account that doesn't belong to the borrower). However, it was quite effective in identifying patterns of missing data and inconsistencies in the files.

The authors concluded that "Although credit reporting company data are extensive, they are not complete. First, information on some credit accounts held by individuals is not reported. Some small retail, mortgage and finance companies and some government agencies do not report

[85] Avery, Calem and Canner (2003).

to the credit reporting companies. Loans extended by individuals, employers, insurance companies and foreign entities typically are not reported. Second, complete information is not always provided for each account reported. Sometimes creditors do not report or update information on the credit accounts of borrowers who consistently make their required payments as scheduled. Credit limits established on revolving accounts are sometimes not reported. Creditors may not notify the credit reporting company when an account is closed or undergoes other material changes." [86] They also noted that credit report information is perishable—some pieces of information (e.g., outstanding balance on revolving credit card accounts) become outdated the day after the information is sent to the credit bureau. All of these issues make credit files merely an approximation of the borrower's credit profile.

The authors raised the following issues of particular concern:

1. ***Missing Credit Limits.*** About one-third of the open revolving accounts in the sample were missing information on the account's credit limit. Consequently, about 70% of all consumers in the sample had a missing credit limit on one or more of their revolving accounts. Missing credit limits are a concern because the credit limit on a revolving account is used to calculate revolving account utilization (how much of an available credit line the consumer has utilized), which is an important determinant of overall credit score. Risk studies have found that a higher utilization rate correlates to higher risk. On accounts missing the credit limit, creditors will typically substitute the highest previous balance (if available) in place of the actual account limit. This typically will overstate utilization and, therefore, overstate risk.

   Further analysis showed that the missing limits were mostly attributable to a small group of creditors (12% of all creditors accounted for 74% of all missing limits) who reported limits on fewer than 5% of their accounts (i.e., they were apparently routine non-reporters of limits). The authors also found that for the most part the non-reporting of limits affected prime and subprime consumers equally. There was no strong evidence of discriminatory underreporting on subprime accounts (to shield them from competition).[87]

[86] Ibid, p 50.
[87] Ibid, p 60.

However, there was a small group of creditors (5% of all creditors in the analysis), all of whom specialized in subprime lending (more than 50% of their accounts), who reported credit limits more selectively, reporting 77% of limits for prime customers vs. 40% for subprime customers. The authors note that their findings on missing limits are especially sensitive to the time period in which the sample was drawn (June 1999). In the late 1990s several large credit card issuers had stopped reporting account limits for competitive reasons.[88] Pressure from credit bureaus and the banking regulators substantially reduced the problem, so that by 2003, industry officials were reporting that credit limits were missing on only about 13% of accounts.[89]

2. ***Balance Information Significantly Out of Date.*** One of the useful dimensions of a comprehensive credit report is that it supports the calculation of a borrower's total outstanding debt. This requires accurate and timely information on outstanding balances. Three quarters of all accounts in the sample reported balances without ambiguities. That is, the accounts were listed as open and updated within 2 months of the sampling date, or the account was reported as closed and had a zero balance at time of last reporting. An additional 18% of accounts were dormant, i.e., last reported more than 2 months earlier and showing no outstanding balance. Consequently, creditors could determine balance unambiguously on 92% of accounts. However, 8% of all accounts showed positive balances but had no recent reporting of activity (last report was more than 2 months prior to sample date). And, these balances accounted for more than 25% of total balance dollars (many of these were mortgages). In addition, nearly 60% of all accounts that indicated a major derogatory item at last reporting were among these 8% of accounts for which the actual balance was questionable. The authors' analysis indicates that many of the non-derogatory accounts (especially mortgages and installment loans) in this group were likely closed or sold to other companies, but weren't reported as such. Recognizing this problem, the credit repositories have developed "stale account" rules that will reset balances to zero and mark an account closed under certain conditions. However, accounts with a major derogatory and an outstanding balance listed as the last reported status can have a significant negative impact on consumers applying for credit.

[88] Fickenscher (1999), p 1; Timmons (2000), p 110.
[89] Avery, Calem and Canner (2003) p 73.

3. ***Reporting of Only Negative Information.*** About 1-2% of all accounts were reported by creditors who only report negative information. These creditors do not report accounts in good standing. This is common in many other countries, and remarkably low, by comparison, in the U.S.[90] Negative-only reporting poses two problems: 1) because some consumer accounts and balances are not reported, it masks over-indebtedness problems that may develop into payment problems, leading to erroneously positive risk assessment for some borrowers, and 2) some consumers miss out on the positive effects on creditworthiness of well-handled accounts, because their accounts in good standing are not reported.
4. ***Non-reporting of Minor Delinquency.*** About 11% of all accounts are reported by creditors who do not report delinquencies of less than 120 days. An additional 12% of all accounts were reported by creditors that do not report delinquencies of less than 60 days. In other words, there is a significant amount of underreporting of delinquency in the system, even though data on payment problems has been shown to be the most predictive factor in scoring models.[91] As a consequence, the credit scores of many borrowers are *higher* (better) than they would otherwise be.
5. ***Inconsistent Reporting of Public Records, Collection Agency Accounts and Inquiries***. For consumers with derogatory public record information or collection agency activity in their files, about 40% have more than one such record. Analysis suggests that for many of these consumers, the multiple listings are associated with the same episode (e.g., one record posted when collection action initiated, another record posted when account paid.) To the extent the creditor risk assessment tools count these flags as separate incidents when they are actually not, it could erroneously penalize consumers. But, there were not codes in the data to allow a creditor to distinguish multiple events associated with the

[90] Although U.S. credit reports do not always reflect all past and current credit obligations for consumers, the United States leads the world in the comprehensive nature of credit reports for each consumers. For most consumers, accounts (past and present) in good standing far outnumber delinquent accounts. Gaps in the reporting of so-called "positive" credit information (i.e., accounts in good standing, or accounts that were paid as agreed and closed) is the norm in many countries. Indeed, several countries (e.g., France, Australia, Hong Kong) *prohibit* the reporting of positive credit information in the name of protecting consumer privacy. Research has demonstrated that positive information significantly improves the predictive power of risk scoring models, effectively giving the borrower an opportunity to demonstrate responsible payment behavior, and giving lenders a means of estimating the borrower's total debt usage. For more details Barron and Staten (2003).

[91] For more detail on the relative weighting of credit report variables in determining a borrower's credit score, and the potential impact of scores on loan interest rates, see the Fair Isaac Corporation website at www.myfico.com.

same incident from multiple incidents. The same was generally true of multiple inquiries in a credit file: creditors failed to provide the appropriate code for their inquiry in 98% of the inquiry records. Consequently, a creditor examining multiple inquiries in a credit file would often not be able to determine if multiple inquiries reflected shopping around for the best loan to finance a single purchase, or applications for multiple loans. The first interpretation would have much less impact on risk assessment than the second.

Discussion of FRB Findings

The problems identified in the FRB report involve credit file information that is missing, clearly outdated, or ambiguous. Systematic correction of the data shortcomings in each of these categories (if it were feasible) would unambiguously improve the performance of risk models by providing a more accurate picture of each borrower's credit profile. Interestingly, the authors note that the resulting improvement in clarity would not unambiguously help consumers. It would help some consumers and harm others. For example, some consumers with unreported accounts in good standing are harmed by not getting credit for building a good credit record. Others are helped because creditors don't see the full extent of their indebtedness. Similarly, more complete reporting of revolving account limits helps those whose balances are well below limits and harms those with balances at or near the limits.

Most of these problems stem from non-reporting in a voluntary reporting system, or from the failure of data furnishers to use available codes to clarify the information being reported. The authors suggest that creditors and the credit repositories could jointly develop better codes and reporting protocols for public records and inquiries and encourage their use. The repositories could also expand and refine their stale account rules and flag the accounts from creditors that are no longer reporting information. These steps would clean up some of the ambiguities in the data. In the meantime, most of these problems are well known to creditors and require them to modify the models and rules they use to make decisions.[92]

Consumers could eliminate many of these problems by taking a more active role in reviewing their files. But, vigilant consumers will not correct all of the problems. The authors

[92] For example, mortgage lenders now commonly require a consolidated credit report on borrowers that merges information from all three of the major repositories. This reduces the risk posed by data missing from a single repository's file. Regarding ambiguous creditor inquiries, Fair Isaac has indicated that it modified its FICO risk scoring algorithm to recognize multiple inquiries from the same type of lender within a short time period as related to a single transaction (e.g., multiple inquiries from auto dealers or auto finance companies.)

observe that even if consumers did take a more active role, they would introduce their own bias into the error correction process, stemming from their own self-interest. That is, those consumers who find problems in their files for which correction will help them will likely report them. Those for whom corrections would harm them likely won't. Missing information, ambiguous information and outright incorrect data would remain in files whenever resolution would identify the consumer as higher risk.

Consumer Federation of America Study, 2002

Another recent study was sponsored by the Consumer Federation of America (CFA) and jointly conducted with the National Credit Reporting Association in 2002.[93] The CFA report resembles the FRB study in that it identifies and tabulates discrepancies and inconsistencies in credit reports, but it adds a new dimension by comparing reports for each consumer across all three repositories. The study also focuses on the magnitude of differences in consumer credit scores across repository files caused by the inconsistent content. Given the pervasive use of credit scoring across all segments of the consumer loan industry, including mortgage lending, large differences in scores based on variance in file content can have serious implications for consumers. Of course, the problem stems from the variance in content of the underlying credit files and not the scoring models *per se*. Differences in content across files have always existed to some degree, and mortgage decisions in the days before scoring had to take them into account just as they do now. Nevertheless, critics of automated underwriting in mortgage lending worry that the acceleration of the underwriting process (time between application and decision) that credit scoring has made possible may be causing some lenders to give short shrift to investigation of differences in credit scores for an applicant, especially in regard to the pricing of the loan.

To determine the frequency with which file discrepancies across the repositories generated relatively large differences in credit scores, the CFA report undertook a manual review of a sample of 1,704 combined credit files for consumers who had applied for mortgages during June, 2002. The sample was draw from the archives of three credit reporting agencies (not the three major credit repositories) that collectively served consumers in 22 states. The combined files (which consolidate separate credit reports from each of the three major repositories) had

[93] Consumer Federation of America (2002).

been requested by mortgage lenders, along with calculated FICO risk scores from each repository, in conjunction with mortgage applications.[94] The CFA study also conducted a more intensive review of a 10% random sample of the combined credit files supplied by one of the participating agencies (a total of 51 files). As was the case with the FRB study, the CFA approach can't identify whether information in the file is correct or incorrect. It can identify inconsistencies and missing data. The CFA sample is not a representative national sample of all borrowers, but for this sample of mortgage applicants it provides intriguing information on the differences in file content across the major repositories. The results included the following:

1. ***Score Differences.*** Twenty-nine percent of consumers had a range of 50 points or more between their highest and lowest FICO scores. Five percent of consumers had a range in excess of 100 points.
2. ***Fragmented and Mismatched Files***. About 10% of borrowers had multiple files returned from a single repository. Some were attributable to credit accounts under the applicant's nickname that had not been properly matched with the applicant's other file. Others had a transposed social security number but had sufficient other information in common to determine it was the same person. Still others appeared to represent different people, with no common credit experience between them.
3. ***Types and Frequency of Inconsistencies.*** The in-depth review of 51 combined files quantified the inconsistencies that undoubtedly led to the variance in FICO scores. The report divided these into two categories, errors of omission and errors of commission.

The report found evidence that of what it termed errors of omission as follows. One-third of combined files had a mortgage reported by one repository but not all. Two thirds of files had an installment loan reported by one repository but not all. Seventy eight percent had a revolving account reported by one repository but not all. Negative information was missing less often than positive information. The latter result is not surprising, given the worldwide tendency of data furnishers to report negative information more readily than positive information. For example,

[94]A FICO risk score is a widely used statistical risk scoring product sold by Fair Isaac Corporation. In drawing the sample, the report states that the participating agencies took "consecutive archived files dating from June 17 to June 20, 2002." See Consumer Federation of America (2002), p 15. One agency that served multiple time zones selected every second file generated over the 4-day period to ensure representation of consumers across all regions.

12% of combined files had a revolving account with late payments reported by one repository but not all. Eight percent had a revolving account with a chargeoff reported by one repository but not all. Twenty percent of files had a medical account collection reported by one depository but not all. Twenty-five percent of files had some kind of collection omitted by one or more repositories.

These findings serve as a reminder of the voluntary nature of the credit reporting system in the United States. They also highlight the fact that the credit histories for most adults today (certainly anyone over the age of 40 who has been active in credit markets for the majority of their adult lives) still reflect the regional roots of the reporting industry. All credit bureaus evolved from local operations. The companies that eventually became the three major repositories had recognized regional strengths and weaknesses as recently as a decade ago, when even medium-sized banks, retailers, mortgage companies and other creditors would deal with one but not all of the repositories. Some of that reporting heritage remains in the credit files of older adults. Moreover, the lack of universal reporting persists today for many public record items, including collections associated with local doctors, hospitals, and other businesses that extend credit. The fact that such differences exist explains why mortgage lenders want combined reports from all three repositories, in order to catch missing information. In all likelihood, these differences will slowly fade over time as younger consumers obtain credit in an increasingly national market and the repositories devote resources to capturing public record items in all localities.

As for errors of commission, the CFA report used this terminology when the repositories reported conflicting information on the same account. For example, 43% of combined files had conflicting information across repositories about the number of times an account was 30+ days late. However, the authors do not report how many of these could be differences of only one instance, which could result from a delinquency in the most recent period that is reflected in one depository but not yet in another due to different reporting/loading timelines. The report mentions that this may have occurred in some instances, and notes that it also occurs on reports of older delinquencies, but does not provide details as to how often.[95]

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[95] Fair Isaac responded by noting that they recognize the potential for differences in the number of reported delinquencies on the same account, so they do not include this in their FICO models. They do include the number of different accounts on which the consumer has been delinquent. St. John (2003), pp 14-16.

In addition, 23% of files had conflicting information on the number of times an account had gone to 90 days late.[96] Account balances had inconsistencies on 82.4% of combined files. Inconsistencies on reported limits occurred in 96% of files. The authors admit that their view of credit limits is restricted by the software that was employed to review the reports, which lumps credit limit and high credit into one field.

Discussion of CFA Findings

The CFA findings echo the central results from the FRB study: information about various elements of a consumer's credit experience is frequently missing from credit files, a fact which becomes even more apparent when credit file content is examined and compared across three repositories instead of just one. Notwithstanding the claim regarding errors of "commission," the CFA study is unable to quantify how often reported information is erroneous.

The CFA report begins with an implicit assumption that a consumer's credit report should look the same across all 3 repositories, and expresses alarm over the degree of inconsistency, and the resulting large variance in credit scores for some consumers. We would expect some inconsistencies, however, given the voluntary nature of reporting in the U.S. and the participation of 30,000 furnishers of information, many of whom report to only one or two repositories. Add to that the logistical differences in timing across the three repositories as to when information is received and posted to a file. The CFA report admits that some unknown number of the "errors of commission" likely reflect differences in timing of the updates posted at the repositories. For all of these reasons, any assessment that tabulates "errors" based on finding inconsistencies across reports from the three repositories (as the CFA report does) will find plenty of supporting evidence.

Because of differences in file content across bureaus, a single consumer's credit score will differ depending upon which bureau file is used. But, creditors have long known that the depth of credit files differed across the repositories, depending upon the geographic location of the consumer, and have adjusted their decisions to purchase credit reports accordingly. Of course, these potential differences are the primary reason why mortgage underwriting typically

[96] This rate seems extraordinarily high, given that the nationally representative FRB study found that 85% of all accounts had no record of late payment at any time, and that only 8.7% of all accounts had ever experienced a delinquency of 90 or more days. It is all the more striking since the sample consists of mortgage applicants, who would tend to have better credit histories, on average, than the population of all borrowers. This may signal a problem with the sample.

requires a consolidated report based on reports from all three repositories. Other types of lenders (credit card, auto) may still use only one or two reports, but may select the repository believed to have more comprehensive files in the geographic region where the consumer resides.

Perhaps the most interesting insight from the CFA study is the frequency of multiple (but different) files returned for a given consumer. This cuts to the heart of the repositories' biggest challenge: matching billions of pieces of incoming data (per month) to the correct file in order to create a comprehensive picture of a consumer's credit history. Obstacles abound. Application information sent with the initial account opening may contain variations of a consumer's name, and contain small but potentially vexing inconsistencies in the address.[97] Some will occasionally have errors in the applicant's social security number. Forty two million Americans move each year and information with new addresses has to get properly matched to the preexisting file.

The repositories developed matching algorithms to handle these problems. A multiple or fragmented file was created when a repository couldn't achieve a reliable match. Rather than discard new data (error of omission), or add it to an existing file without a reliable match (error of commission), the repository would open a new file with the new data. The fragmented file problem eventually led to consumer alarm about the accuracy of credit reports and a series of Congressional hearings to deal with accuracy issue beginning in the late 1980s.[98] However, the repositories' primary customers, the major national credit grantors, were already applying market pressure for better solutions. Beginning in the late 1980s, the repositories' degree of success in solving these problems became an important source of competitive advantage as they competed for commercial customers.

Fragmented files created an acute operational problem for creditors when many credit card issuers began relying heavily on prescreened solicitations in their national marketing campaigns to obtain new cardholders.[99] After observing higher-than-expected delinquencies on new cardholders obtained through prescreened offers, creditors discovered that some of the

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[97] Jane Smith's name may be recorded in a variety of different ways on different accounts depending upon what she used at the time the account was opened (e.g., J. Smith, J.Q. Smith, Jane Q. Smith). Jane may have changed her name when she was married. She may have listed the same address on all of the accounts, but with slight differences (e.g., "123 Main," "123 Main Ave." "123 S. Main Ave." "123 Main, Apt. B"). If Jane is one of 6 million Americans who own vacation homes, she may have opened an account once on vacation and used the vacation home address.
[98] See *Oversight Hearing on the Fair Credit Reporting Act* (1989).
[99] In preparing a prescreened card offer, a creditor asks a credit bureau to provide a screened listing of candidates for credit offers who meet the creditor's specific standards for acceptable risk. Consumers that pass the screening test receive direct mail or telephone solicitations that invite them to apply for a "pre-approved" card.

credit reports used to generate the prescreened lists were incomplete. In these partial or "fragmented" files a customer's credit history was split between two or more separate files. Consequently, neither file on the consumer reflected a full credit history. One file might pass a prescreen test, despite the presence of negative information in a separate file elsewhere in the database.

To counter higher than expected delinquencies among new cardholders, many national credit grantors began post-screening the applications received from the prescreened customers. That is, a full credit report was routinely purchased after receipt of the application to determine if the customer was indeed creditworthy. Because the application typically contained the cardholders' social security number and other identifying information, the various fragmented files were usually linked in response to the creditors request. Having to post-screen raised the issuer's cost of acquiring new accounts. The value of an accurate prescreen rose further, as did the market pressure on the repositories to reduce fragmented files, when the FTC sharply limited postscreening in 1991.[100]

In response to both market and regulatory pressure, the credit reporting industry began adopting and expanding a series of procedures to improve the accuracy of files, including the following: 1) development of new algorithms to improve file matching, 2) creation of a standardized reporting format to be used by creditors when supplying data to the bureaus, and 3) voluntary cooperation among the three major repositories to share information on corrections.[101] By 1996 more than 95% of all data reported to bureaus was received in the standardized "Metro" format.[102] By 2003, over 99% of the total volume of 2 billion records reported per month was received in Metro 1 or Metro 2 format.[103] However, given the CFA's finding that multiple files were returned on 10% of consumers in their sample, apparently a problem with fragmented files still remains.[104]

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[100] For more on creditor frustration with the fragmented file problem see Daly (1991), pp 46-52.

[101] For an extended discussion of non-legislative, self-regulatory measures that had been implemented or were being discussed by the industry in 1991 see Spurgin (1991), pp 10-16.

[102] "Both the original (Metro) and the new Metro 2 formats are maintained by an industry committee of volunteers from each of the national credit reporting systems. This group meets on a regular basis to develop industry-wide responses to questions from data furnishers and create new codes or fields as necessary." Testimony of Stuart K. Pratt, (2003), p 17.

[103] U.S. General Accounting Office (2003) pp 12-13.

[104] Keep in mind that these multiple files may be the legacy of less efficient matching routines in the past. Even if matching algorithms today have significantly reduced the creation of new instances of fragmented files, some old fragments remain in the system. The only additional empirical evidence we have found on this point is that the

Actual Disputes as a Proxy for Errors of Commission

As the GAO report noted, statistically representative studies that quantify the frequency of errors of commission (i.e., the inclusion of items in a credit file that do not belong to the consumer) are rare. In large part this is because they require 1) a sample of consumers representative of some larger population, 2) their cooperation in examining credit reports for discrepancies, 3) reinvestigation of alleged discrepancies to determine whether the items needed correction, and 4) the involvement of an independent arbiter to determine which of the corrected discrepancies are relevant to the credit-granting decision.

To our knowledge, no study has been conducted that incorporates all of the attributes listed above. [105] We are aware of only one study that approximates these conditions. In 1991 the credit reporting industry trade association, Associated Credit Bureaus, commissioned Arthur Andersen and Company to conduct a "Credit Report Reliability Study."[106] Rather than selecting a representative sample of all consumers and asking them to review their credit files, the Andersen study focused on a random sample of 15,703 consumers who had applied for and been denied credit during a 60-day period in 1991. As required under the FCRA, each of these consumers had received adverse action notices alerting them that they had been turned down based on information in their credit report and that they could request and review their credit report free of charge.

The Andersen study tracked the number of consumers who responded, and subsequently disputed information on the report. It found that 1,223 (7.7%) consumers requested a copy of their credit file. Of these consumers, 304 (2.5%) disputed information in the file. Reinvestigation was conducted as required by FCRA and the creditors were asked to re-evaluate the original application based on the outcome of the reinvestigation. By the time the study was published,

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frequency of multiple files in the CFA study was somewhat lower than what was reported in a study conducted by Visa U.S.A. of fragmented files based on 1995 data. That study examined the credit files of applicants who had been selected for credit card solicitations based on a prescreening process with the repositories and who had subsequently applied for the card. The study found that multiple files were returned on 9-14% of the applicants. See Visa U.S.A., Inc. (1997).

[105] Two widely publicized studies conducted during the late 1990s by USPIRG (1998) and Consumers Union (2000) sought to identify the frequency of errors of commission. However, their samples were not representative (they sampled organization employees who verified the accuracy of the information in their own files). Moreover, the GAO noted that the studies counted any inaccuracy as an error, regardless of its potential impact, used varying definitions in identifying errors, occasionally provided obscure explanations of how they carried out their work, and did not consult with industry representatives for guidance or clarification on interpreting the data. See U.S. General Accounting Office (2003) p 9.

[106] Arthur Andersen and Company, "Credit Report Reliability Study," 1992.

reinvestigation had been completed on 267 of the 304 cases, yielding 36 cases in which the original decision to deny credit was reversed based on the new information. Andersen concluded that "of all those consumers (1,223) who requested to review their file, the results of the study indicated that *less than 3% of these consumers for which this study has been completed would have achieved a different credit decision than was originally rendered by the credit grantor after initial review of the information contained in the credit report*."[107]

Further reflection indicates that 3% is likely an upper bound on the rate at which file errors caused an adverse credit decision, and that the actual percentage could be substantially lower. Only 7.7% of consumers who were denied credit bothered to request their credit report. There are at least two potential explanations for what appears to be a strikingly low incidence of follow-up to the denial. One explanation could be consumers' lack of awareness of credit reports, their importance in the credit-granting process, or that the reports could contain errors that would generate an adverse credit decision. Another explanation could be that many, if not most, customers turned down for credit were not surprised at the turndown because they were already aware of problems with their credit history that were likely reflected in their credit report. To whatever extent the latter statement characterizes a segment of the sample, it is clear that by focusing on consumers who respond to adverse action notices the study methodology was biased toward finding a higher error rate than that which characterized the entire population for two reasons: 1) those consumers who receive an adverse action notice are more likely to have data in their file that triggers a negative decision than those who do not receive notices, and 2) those consumers who request their reports after a turndown were more likely to turn up errors than those who did not.[108] It should also be noted that the Andersen study was conducted at a time when risk-based pricing was in its infancy (and virtually non-existent for mortgages), so that a study focused on recipients of adverse action notices would come closer to identifying the proportion of all consumers who had been penalized by credit report errors than would be the case today.

[107] Arthur Andersen and Company (1992) Executive Summary.

[108] To illustrate, if we made the extreme assumption that none of the reports contained errors that would have changed the credit decision for the 92.7% of consumers who did not request a credit report following their adverse action notice, then the incidence of erroneous credit decisions caused by credit report errors would fall to 0.2%, i.e., two-tenths of one percent of all credit denials in the sample attributable to credit file errors. The true percentage likely falls somewhere between this figure and the Anderson study estimate.

The Andersen study was based on the reporting system a dozen years ago. We simply do not know how such a study would turn out today, and none has been conducted since. Contemporary evidence on the quality of credit reports is suggestive, but indirect. For example, the Credit Data Industry Association (CDIA) presented some related statistics during its testimony at the Senate FCRA hearings during the summer of 2003.[109] As part of its fraud assistance services, CDIA members provide credit reports to consumers who request them because they suspect they may be at risk or have already become victims of ID theft and fraud. CDIA members provide approximately 100,000 credit reports a month for this purpose. On average, they receive 10,000 follow-up contacts from recipients per month on their toll-free numbers. These contacts do not necessarily equate to disputes as the consumer may simply be calling with questions on a number of issues. In other words, in this group of people who inspect their credit reports because they have prior reason to be concerned about fraudulent activity, no more than 10% ended up disputing any items in the report.

Additional information was supplied by one or more of CDIA's members in the form of summary statistics on credit reports delivered to subscribers to one of the "alert" services marketed by the repositories. As part of these services, consumers receive alert bulletins from the repository if their files indicate a triggering level of inquiry activity (indicating someone may have been applying for credit in their name) or they had additional adverse information added to the file. On average such fraud alerts resulted in about 180,000 credit files issued to subscribers per year over a 2- period. Subsequently, about 5% of consumers contacted the bureaus with a question or dispute. Apparently the other 95% were not surprised by the information in their files.

The reporting industry estimates that approximately 16 million credit reports are issued to consumers per year. About 84% of these are free disclosures in response to consumers' requests following adverse action. Another 10% are provided in response to a fraud claim. Between 5-6% are sold to consumers who request them out of curiosity. Across all these issued reports, about 50% of the recipients call the bureaus' toll-free numbers with a question or dispute. This is a substantially higher contact rate than was found in the Arthur Andersen study a decade earlier. It is not possible to determine from the reported data whether this is due to heightened consumer awareness of the importance of credit reports, a greater demand for accelerated updates of

[109] Testimony of Stuart K. Pratt, president of the Consumer Data Industry Association, (2003).

information contained in the file (perhaps as a consequence of greater reliance on credit scoring in the mortgage granting process), a higher incidence of disputable items, or a combination of these and other factors. CDIA reported the following industry-wide breakdown of results of the dispute resolution process.

Dispute Resolution Results, CDIA members 2003

Type of Result Based on Dispute Submitted	**Percentage**
Information verified as reported	46%
Data modified per data furnisher's instructions *(Note that data may have been modified due to an update of information, rather than a dispute about accuracy of the data as of the date originally reported)*	27%
Data deleted per data furnisher's direction	10.5%
Data deleted due to expiration of the 30-day reinvestigation period and no response received from data furnisher. *(It cannot be determined whether the data was accurate as of the date reported.)*	16%

Source: Pratt (2003)

CDIA emphasizes that many times disputes evolve over information that was accurate at the time it was reported. In these cases, consumers who dispute an item are actually seeking to *update* the item. For example, to complete the qualification process for a mortgage loan the consumer may be seeking to update the information sooner than the regular 30-day reporting cycle in order to document lower balances, closed accounts or delinquencies that have been resolved. In other cases, a consumer may dispute an account that is not recognized because it has been inactive for several years, or has been sold to a creditor whose name the consumer does not recognize (common with mortgage loans and retail credit card accounts). Consequently, in the table above, the items that result in changes to the file do not necessarily reflect instances in which the data was inaccurate at the time initially reported. And, to repeat a point made earlier, not every change to information in the file involves an item that would have a material impact on the consumer's creditworthiness or credit score.

Discussion of Evidence from Disputes

Errors of commission do occur in credit reports, but the available evidence does not support a firm conclusion as to the frequency in current files. Available information suggests that such errors do not occur any more frequently today than a decade ago, but the evidence is limited. A statistically valid study demonstrated that in 1991 less than 3% of loan application denials were the result of erroneous information contained in credit reports. More recently, over the past two years, we know that for two groups of consumers who had reasons (other than adverse action from creditors) to believe there might be problems with their credit reports, and were given an opportunity to review their reports, only 5-10% of them made a follow-up contact with the bureau with a question or dispute. Since not every callback involved a dispute, and not every disputed and corrected item would have affected a consumer's qualification for a loan, these percentages seem at least roughly consistent with the 1991 results.

We also know that, in comparison with 1991, a significantly higher proportion of consumers who received credit reports in 2002 (approximately 50%) contacted the credit bureau with questions or to dispute information in the report. Of course, the higher contact rate does not necessarily imply a higher frequency of identified problems. Indeed, to the extent that education efforts on the part of the FTC, consumer groups and the industry have been successful in encouraging consumers to do their part in "quality control," we should expect a higher rate for both credit report requests and callbacks.

For those consumers that called to dispute items, we know that 46% of all disputes in 2002 were resolved with no change to the credit file. But, we do not know the proportion of the remaining 54% of all disputes that arose from information being posted to the credit file that was inaccurate at the time of posting. In 37% of all disputes, we know that a change was made to the file as a result of the consumer's intervention, but in two-thirds of these cases the furnisher instructed the bureau to modify the data in the file (as opposed to delete items), suggesting that the change may simply have been an update rather than the correction of an initial error. Clearly, consumer intervention is improving file quality. But, it is not clear whether this is due to accelerated posting of information vs. correction of erroneously posted items.

A more disturbing finding is that 16% of all disputes resulted in data being deleted from the file due to expiration of the mandatory 30-day reinvestigation period under the FCRA. CDIA has testified that a common tactic of so-called credit repair clinics is to flood the bureaus with

disputes on multiple items in a consumer's file, in hopes of getting items deleted because the dispute resolution process becomes overloaded and exceeds the allowed 30 days.[110] On the other hand, it is possible that some of these disputes are cleaning up old accounts for which the original creditor no longer exists. The latter outcome is a positive development for file quality while the former outcome erodes file quality. The available data simply do not support an assessment of how often each is occurring.

Consumer Awareness of Credit Reporting and their Role as Monitors

In 1979, the Credit Research Center at Purdue University conducted a survey of bank card holders in California to assess their understanding of the function of credit bureaus.[111] Only 37% correctly identified credit bureaus as record-keeping agencies. No significant relationship existed between the consumer's awareness of the true role of credit bureaus and occupation, income or education, or the number of credit card accounts owned. The study concluded that consumers' knowledge of credit bureaus was quite limited. Given that relatively little media attention was paid to the industry until the end of the 1980s, it seems reasonable to assume that consumer perceptions of the work of credit bureaus did not advance much between the time of the CRC survey and the wave of federal proposals to amend the FCRA beginning in 1989. For its part, the reporting industry did relatively little to educate consumers.

As we have seen, much of the FCRA's effectiveness hinges on consumer willingness to exercise the power to monitor their reports. Given the heightened consumer awareness of credit scoring (especially for mortgages), concerns over identity theft, and media focus on credit reporting, it seems likely that consumers would request their reports more often than was the case 10 or 15 years ago. In Congressional hearings a decade ago, the industry's trade association (Associated Credit Bureaus) testified that consumers in 1989 requested about 9 million credit reports per year (based on an underlying pool of approximately 150 million files on consumers). About 90% of these requests were free disclosures following adverse action taken on the basis of

[110] "Note that credit repair can have a deleterious effect on the completeness of a consumer's credit report and, thus, where third-party file comparisons identify absences in data across files, this is in part attributable to credit repair. One of our members testified that more than 30 percent of all consumer disputes were generated by credit repair agencies, which commonly dispute accurate, derogatory information with the sole intention of having that information deleted from the file." Pratt (2003), p 4. In 1996, Congress took steps to criminalize credit repair tactics with the enactment of the Credit Services Organization Act (PL 90-321, 82 Stat.164).
[111] Dunkelberg, Johnson and DeMagistris (1979).

data in the report. The remaining 10% apparently stemmed from curiosity about the file. Bureaus received about 3 million requests (33%) for re-verification per year.

By comparison, as of 2002 about 16 million credit reports were issued to consumers annually (based on an underlying pool of approximately 200 million files on consumers). About 84% were free disclosures in response to consumer requests following adverse action. Another 10% were provided in response to a fraud claim, and between 5-6% were sold to consumers curious about their file. About 50% of report recipients contacted a bureau with a question or dispute.

These numbers are strikingly similar, despite the increased public awareness of credit reports and scores. Between 1989 and 2002, the number of credit reports distributed to consumers, as percent of total consumer credit files, rose only slightly from 6% to 8%.[112] But this seemingly low percentage of inspected files is somewhat misleading. Every application for credit creates an opportunity for detecting a serious error in the file. If the applicant was *unexpectedly* turned down, an error could well have been the culprit, and the mandatory adverse action notice would likely trigger a request from the consumer to see a report. The relatively small number of requests could simply be signaling that accepted applicants had feedback that there were no serious problems in their files, and that rejected applicants were well aware of their troubled payment history and didn't need to see a credit report to confirm it. Thus, the adverse action notice feature of the FCRA provides an ongoing monitoring and alert service, giving consumers a basic signal and the option to investigate further or not based on their own private information.

We expect that the number of reports requested by consumers will grow. There is ample evidence that a sizeable segment of the U.S. population is willing to pay for various alert services and enhanced disclosures of credit file characteristics and credit scores. All three of the major repositories offer an array of such products on their websites, some of which cost over $100 a year.[113]

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[112] Total requests for credit reports were spread across all three major repositories and some consumers undoubtedly requested reports from all 3 repositories. Consequently, the number of requests overstates to some degree the number of consumers who actually reviewed their files.

[113] A recent survey by *Privacy and American Business* and Harris Interactive found that 33.4 million Americans have purchased a privacy product to avoid identity theft, check their credit report, or surf or shop online. See Hendricks (2003), p 3.

Indeed, it seems that the repositories are increasingly recognizing product sales to consumers as an important source of revenue growth. That trend seems likely to accelerate, and is a positive development in terms of improving credit file quality. As bureaus compete and acquire hundreds of thousands (perhaps millions) of new consumer customers, they will revamp and upgrade their customer service operations. More importantly, the growing demand for dispute resolution from the growing number of "informed" consumers will require the repositories to develop new processes to minimize the costs of resolving disputes, and to prevent problem items from appearing in files. These actions in response to market incentives benefit the rest of us who choose not to subscribe to one of the alert services or inspect our own credit report.

Market Forces, Regulatory Action and Legislated Mandates

The 1996 amendments were the only major legislative revision to the FCRA for 25 years, despite dramatic change in the technology of lending and credit reporting, and equally dramatic changes in the market structure for both. During that time the U.S. evolved the most dynamic and competitive consumer financial services market in the world. Both competitive market pressures and regulatory oversight contributed to this result, all within the framework of a largely unchanged FCRA.

Market pressures begin with creditors and other users of credit reports who value accuracy in reporting for the simple reason that accurate files improve the precision of risk assessment tools. Creditors constantly evaluate the efficiency of their scoring models, and seek ways to improve their performance. In some cases this involves modifications to models or procedures to accommodate known problem areas in reporting.[114] In other instances, creditors apply market pressure on bureaus to improve the quality of their files.[115] This pressure,

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[114] The combined credit reports that are now commonly required for mortgage applications are perhaps the most prominent example. In another example, the classic Fair Isaac FICO scoring model is constructed to utilize public record information on the presence of a collection item, and the amount of time since it was posted, but not the number of collection items, which the FRB study noted could overstate the number of delinquency events. Fair Isaac has also indicated that its scoring models evaluate the date of last activity on accounts only in rare cases, acknowledging the fact that files from the three repositories on the same consumer often have conflicting information.

[115] A good example already discussed is the problem of mismatched and fragmented files which generated intense market pressure on bureaus in the late 1980s and early 1990s to improve their file matching algorithms or risk losing the lucrative revenues from their prescreening products.

especially from the largest national creditors, can be highly effective since they are the bureaus' largest customers. More recently, bureaus have felt a new form of market pressure as they court millions of consumers as customers for their various credit report, credit score and fraud alert products.

However, over the history of the FCRA, many of the voluntary industry initiatives that deal more directly with consumer notification and dispute resolution have undoubtedly been hastened by the threat of regulation and legislation. Two key regulatory developments in 1991-1992 pushed the repositories to address a number of file quality problems. In December, 1991, TRW (later known as Experian) signed Consent Orders settling separate cases brought by the FTC and 19 state Attorneys General. In July, 1992, Equifax signed an Agreement of Assurances with 18 state Attorneys General. [116] Subsequently, the widespread adoption of standardized reporting formats was probably accelerated by the regulatory pressure. Under the auspices of the credit reporting industry trade association, an Automated Consumer Dispute Verification process was constructed and became operational in November 1993. The system was designed to address the frequent criticism that a consumer would get a disputed item corrected with one repository, only to find that it still existed at another. In the automated system, a dispute received from a consumer is sent to the data furnisher and any changes to the file are automatically routed through the network to each of the repositories to which the data was originally reported.[117] CDIA members began (voluntarily) posting fraud alerts to consumer files in the mid-1990s.[118]

Revisions to the FCRA that addressed both accuracy and dispute resolution were eventually passed in 1996, years after the initial concerns over file errors. Given that regulatory pressure was increasing simultaneously with creditor pressure on the industry to adopt voluntary

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[116] Requirements on both repositories were remarkably similar. Included were agreements by both to 1) adopt procedures to prevent the occurrence or recurrence of "mixed files"; 2) follow reasonable procedures, before information is used, to detect logical errors in credit information; 3) advise all subscribers (furnishers of information) that they will be expected to obtain "full identifying information" (as defined in the agreements) on consumers and that they must use that information when reporting on consumers to the credit bureau; 4) adopt extensive procedures when reinvestigating disputed items, complete the reinvestigation within 30 days of receipt of the consumer's dispute, and provide the consumer with the current correct version of the disputed information; and 5) maintain procedures to ensure that erroneous and now corrected items do not reappear on consumer reports. For more details see Feldman (1992), pp 2-3.

[117] The dispute network is known as E-Oscar-web™. See Pratt (2003), p 19-20.

[118] More recently, since October, 2001, CDIA's consumer reporting agency members have supported a nationwide initiative to allow any consumer who is a victim of identity theft to request the removal of fraudulent data where he/she has police report that validates the claim. As of April, 2003, a single call to any of CDIA's nationwide consumer reporting agency members regarding fraud or ID theft is transferred to all agencies. See www.cdiaonline.org for April 16, 2003 press release.

industry-wide initiatives, it is impossible to say how much of the resulting improvements in procedures were driven purely by market forces, how much by regulatory enforcement by the FTC and others, and how much by the threat of new legislation. Clearly, all contributed.

New Problems, New Legislative Proposals

During the 2003 legislative hearings on FCRA reform several new problems entered the public debate, along with recommendations for legislative solutions. We address the three most prominent issues related to credit report accuracy below.

Adverse Action Notices in an Era of Risk-based Pricing

The development of more sophisticated statistical risk-scoring models has given creditors increased confidence in their ability to assess the degree of risk associated with a borrower. In addition, since the late 1970s, most interest rate ceilings on consumer and mortgage credit have been relaxed or removed. Together, these two developments gave creditors the ability to implement risk-based pricing. Higher-risk borrowers who would have been rejected for loans in the past are now approved for loans at higher-than-prime rates. In markets for credit cards, auto loans, and most recently home mortgages, risk-based pricing is now the common practice. Consequently, it is appropriate to think of the loan market in terms of a continuum of borrowers, arrayed from lowest risk to highest risk, with loan interest rates that rise accordingly.

Risk-based pricing poses an interesting challenge for the existing "error-alert" mechanism within the FCRA. Currently, consumers are alerted to the possibility of incorrect information in their credit file by the adverse action notice they receive if turned down for credit or credit-related products. But, with the advent of risk-based pricing, incorrect information may trigger a higher price but not outright rejection. In most cases, no adverse action notice would be sent. Consequently, consumers may not realize that they are overpaying because of incorrect information in their credit report.

It should be emphasized that the application of risk-scoring itself is not the problem here. In fact, the use of risk-scoring models, and a growing awareness by consumers of the "FICO" score as the indicator of creditworthiness, has made it easier for consumers to comparison shop and evaluate their alternatives (in addition to making credit more rapidly available in greater quantities and at lower cost). In the past, most consumers would face a lender with no clear

indication of the criteria being used to evaluate the loan application, and no independent evaluation of their own creditworthiness. Today, in advance of applying for a loan, consumers can rely on the objective (and consistent) criteria of credit scores to get an indication of where they are in the risk distribution and what interest rates they can expect to pay for a given score range. Such products have become a common feature of the websites of the three major repositories, as well as other vendors. This surely gives consumers an advantage in the application process, relative to the days before credit scoring. Marginal, subprime borrowers have probably gained the most from this development.

There is no question that incorrect information in a credit file can trigger a higher loan price. The policy issue turns on whether the definition of an adverse action that triggers the eligibility for a free credit report should be expanded beyond the accept/reject decision to also include pricing outcomes, as some have advocated. The problem with such a proposal is that it trivializes the "alert" function of the adverse action notice. One of the implications of risk-based pricing is that there is a continuum of prices within a portfolio. The majority of borrowers don't get the best rate. Should they get an adverse action notice? Most of us would get adverse action notices every time we applied for credit, even when our credit reports contain no problems. Consequently, the notice loses its ability to signal a consumer that the "unexpected" has occurred, and would likely be ignored. Rather than rely on ubiquitous notices, it seems to us that the best way for a consumer to prevent being over-priced as a consequence of erroneous information in the credit report is to check it in advance of the application.[119]

[119] Proposals to give consumers a free credit report annually, and even free credit score disclosures, have been recommended by consumer groups, have gained some political traction, and seem wholly unnecessary. The fact is that consumers have always had an opportunity under FCRA to monitor their own reports, and an obligation to do their part in ensuring that they remain accurate. After all, the entire system exists to facilitate their commercial transactions and opportunities. The cost of requesting a report, capped under the 1996 FCRA amendments, is dwarfed by the potential savings from detecting errors prior to applying for large loans like automobile and mortgage loans. With so much at stake in terms of the loan price, the notion that a $9 credit report (or even a $30 fee for credit score analysis) would be an obstacle to a home purchase seems absurd.

Non-reporting of Balances, Limits and Accounts in Good Standing

Both the FRB and the CFA reports document missing data fields, and patterns of non-reporting of certain types of information (including derogatory information) by some creditors. Although these omissions could help or harm individual consumers, depending upon the circumstances, they unambiguously reduce the predictive value of credit file information. Therefore, missing information imposes a cost on all users of the credit reporting system, consumers and businesses alike.

To put this problem in perspective, we note that strategic non-reporting of information such as outstanding balances and revolving account limits is far less common in the United States than in other countries. For decades, legislated limits on interstate banking and the constraints of technology ensured that lending in the U.S. was not concentrated in the hands of a small number of institutions. Combined with the mobility of the American consumer, this ensured that creditors gained more than they gave up when they shared information about their customers with a credit bureau. However, this dynamic has been changing over the past two decades. As certain markets have grown more concentrated (i.e., become dominated by a smaller number of increasingly large creditors), some creditors have determined that they stand to lose more than they gain by making certain information (e.g., revolving account limit) available to the credit bureau, and subsequently to competitors. The credit card and subprime mortgage markets in the U.S. are notable examples, having experienced intense competition and rapid growth during the 1990s.[120] Both have experienced episodes of strategic non-reporting. Voluntary information sharing is a dynamic process, and we are seeing it continue to evolve with changes in market conditions.[121]

Some policymakers have proposed that the FCRA should compel reporting of specific data fields (e.g., revolving credit limits).[122] This is the epitome of the prescriptive approach to regulating reporting, and immediately raises a number of questions. Are there some data fields that are so important as to warrant compulsory reporting, and others that are less important, within a voluntary reporting environment? Which fields would they be, who must report, and who should decide? Won't these decisions become obsolete over time? Given creditor proclivity

[120] Hunt (2002), pp 18-19.
[121] Hunt (2002), p 19.
[122] Heller (2003).

to occasionally withhold some information even under the current system, would such mandates discourage participation in reporting altogether?

An important advantage of a *market-driven* system for encouraging and producing "accurate" credit files, as opposed to a legislated or prescriptive system, is that the *market* decides what information should be included and what should be discarded. This gives the reporting system flexibility to focus on the uses to which the file information will be put. The market develops and adapts to new information sources, and creates new predictive models. A more prescriptive regulatory approach (e.g., the public credit registries in many countries that mandate what is to be reported and stored, and who will report), would stifle such innovation.[123] And, no compulsory system in the world has as broad a range of reporting institutions as can be found in the voluntary reporting system in the United States. In large part this is because it is difficult for a compulsory system to anticipate all the uses to which credit report information may be put, the types of businesses that may find it useful (e.g., did Congress anticipate cell phone contracts and video rental clubs in its 1970 framing of the FCRA?), the information that will prove valuable to users of credit reports, and the specific fields that need to be included (and from which sources) for a file to be an accurate representation of the consumer for that purpose.

The FCRA is structured to keep the content of credit reports flexible. For example, while the FCRA requires that older derogatory information be removed from consumer files after 7 years (10 years for bankruptcy), it does not require that such information be stored and reported for the entire period. Nevertheless, repositories continue to report derogatory credit information up to the legal maximum time. Since storage of old information entails positive costs, simple economics suggests that bureaus will retain and report data only so long as its value (enhanced prediction of risk) exceeds the storage cost. If creditors find old derogatory information useful, then they will pay more for files that have it (or purchase reports more frequently). If it is not useful then the deeper files won't allow the bureau any pricing premium, marginal storage costs won't be covered, and the information will be deleted. Studies have found that old derogatory information does have predictive value, and so it is retained.[124] The market's assessment of value drives the collection and storage decision.

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[123] Compulsory reporting may also artificially push companies to devote resources to develop information and predictive tools that utilize non-reported attributes, since only this info can be shielded from competitors.
[124] Fair Isaac Companies (1990), p3. The study found that "the presence of derogatory information continues to distinguish levels of credit risk in the studied populations even as the information ages. The implication of this

In contrast, the employment and income fields in credit reports are examples of items that, in the past, were useful for users of credit reports, but are typically not reported or confirmed presently. The market has found more efficient ways of verifying both, when needed. Vestiges of the older system remain in many credit files, but the information is mostly unused, and is not consistently present or accurate. The market evolved in another direction.

Increased immigration and expanded access to credit to underserved groups have raised the value of developing new signals of creditworthiness for the swelling group of consumers with little or no past credit history. Bureaus are developing utility payment reporting systems, and systems that track apartment rental payments are on the way.[125] No legislation required the development of these additional services, nor would it have been likely to anticipate the need. But, market forces under the auspices of the FCRA are making these new tools available.

What seems clear is that any legislative or regulatory attempts to dictate content, compel participation, or even alter furnisher responsibilities should be mindful of how such actions will affect the calculus of voluntary sharing. Whatever steps are taken to solve the non-reporting problem has to take this delicate balance into account.

One solution to the non-reporting problem would be for the bureaus to tackle the problem by adopting reciprocity codes. That is, they could dictate as part of their subscriber agreements that what a creditor doesn't report, it can't see on any purchased reports. Together with pricing incentives, this could encourage full-file reporting. However, competition among the three repositories for large creditors (especially large purchasers of prescreening services) renders this approach ineffective. For example, what repository will turn away business from Capital One (the large credit card issuer) if it fails to report account limits, when Capital One in recent years has purchased pre-screening services for as many as one billion credit card solicitations annually? The bottom line is that reciprocity agreements can and will be altered as the

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finding is that information predictive of credit risk would be sacrificed by the accelerated deletion of aged references." See also Lyons and Allen (1991). The authors conclude that "significantly more people who declare bankruptcy have older public record derogatory information but non in recent years, than do all people. As a result, if creditors are not allowed to know of public record derogatory information that is four years old or older, they may lose an important predictor of future bankruptcy."

[125] The largest monthly expenditure for about 40% of U.S. households never appears on their credit reports. An Annapolis, MD company has applied for a software patent and is test marketing its program that will track rent payments and make records available to consumer reporting agencies. See Thompson (2002) and Thompson (2003). Fair Isaac Corp. is reportedly developing alternative scoring models that incorporate "non-traditional" credit history information such as rent and utility payments. See Harney (2003).

repositories compete for large customers. A solution might be to give the industry trade association the power to adopt reciprocity codes for the entire membership and withhold services from those that do not comply. This would likely require some special antitrust exemptions, but could reduce the non-reporting problem. It seems to be the most promising avenue for preventing further erosion in file quality due to strategic non-reporting.

Greater Furnisher Liability for Inaccurate Information (Errors)

As described in Section II, the 1996 FCRA amendments placed new responsibilities on credit bureaus and data furnishers to re-investigate and resolve disputes over file content. Some industry critics have proposed even greater furnisher liability for inaccuracies in credit files. However, the existing responsibilities are not necessarily improving the accuracy of files. The 1996 amendments that required bureaus and furnishers to accelerate re-investigation of disputed items may be pushing the system toward deleting derogatory information, the most predictive information in the file. Most disputes involve derogatory information in the file. An effective way to minimize the cost of reinvestigation is to delete the disputed information. To be sure, in some proportion of disputes the consumer is correct and the information should be deleted. But each increase in furnisher responsibilities also increases the incentive to follow the path of least (and lowest cost) resistance and delete the information. Good information is thrown out with the bad, and the value of files is diluted. Some creditors may choose not to report negative information at all. This is not to say that the 30-day reinvestigation period imposed in 1996 was an unreasonable burden. It is simply highlights another example of the many tradeoffs inherent in a voluntary reporting system, and highlights the balancing of incentives that is repeatedly evident within the FCRA. It also serves warning that successive increases in furnisher and bureau liabilities risk moving the U.S. reporting system closer to a positive-only "feel good" system, with sharply reduced predictive power.

Conclusions

We have seen that there is relatively little representative data on the frequency with which specific items contained in U.S. consumer credit reports are wrong. On the other hand, there is ample evidence that, detailed as they are, credit files in the U.S. do not represent an exhaustive listing of all past credit experience for many borrowers. Yet,

despite missing some elements of borrowers' past credit history, U.S. credit files are among the most comprehensive produced by any reporting system globally. More importantly, they support risk assessment tools (e.g., scoring models) that are able to rank borrowers according to likelihood of repayment with remarkable precision. The Federal Reserve Board study concluded that "[o]verall, research and creditor experience has consistently indicated that credit reporting company information, despite any limitations that it may have, generally provides an effective measure of the relative credit risk posed by prospective borrowers."[126] Armed with credit reports as a risk management tool, U.S. creditors have managed to extend substantially more credit per capita and a wider variety of products and services much further down the income spectrum compared to the vast majority of other countries.

We have also seen in the previous sections why tabulations of "credit report errors" (broadly defined) are often not helpful when evaluating how well the credit reporting system is meeting the goal of enhancing credit and economic opportunities for consumers. Certainly, the reporting industry bristles at the suggestion that information that is missing from a file should be counted as an error, since a credit bureau cannot report information that it never receives. The equating of missing information with error rankles all the more because the FCRA itself requires mandatory roll-off of older derogatory information that may still be predictive. Moreover, greater file accuracy is valued only to the extent that it improves the ability of file users to assess borrower risk. Some missing information is important for assessing risk, but other missing information is irrelevant. The same can be said for information included in the file that was never correct, or that was once correct but is now out of date. Not all "errors" are equal, so equating "accuracy" to "lack of errors" can be misleading.

That said, it is also clear that there is room for improvement in making consumer credit reports more complete representations of each consumer's past and current credit experience, free from data about the borrower that was never correct. The problem, of course, is that all of the steps that have been proposed recently in Congress and elsewhere to further reduce credit

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[126] Avery, Calem and Canner (2003) p 51. The authors further observe that "available evidence indicates that these data and the credit-scoring models derived from them have substantially improved the overall quality of credit decisions and have reduced the costs of such decisionmaking. Almost certainly, consumers would receive less credit and the price of the credit they received would be higher, if not for the information provided by credit reporting companies." Avery, Calem and Canner (2003) p 70. See also Avery, Bostic, Calem and Canner (1996).

report errors and inconsistencies impose costs on the credit reporting system. Not all of these costs are obvious (e.g., mandatory tougher matching criteria may result in more frequent turndowns of legitimate instant credit applications). And, depending upon where the regulatory burden is placed, some of these steps could actually worsen the quality of credit files by prompting dropout by data furnishers in the voluntary reporting system.

Prescriptions involving more regulatory requirements on furnishers and bureaus are offered up easily by industry critics, but every one of them involves a tradeoff—imposes a cost—that is rarely articulated. The FCRA is all about balancing these tradeoffs, inherent in any reporting system, but especially so in the U.S. system which owes much of its effectiveness to a reliance on voluntary reporting and competitive incentives.

So what can be effectively done to address the file quality problems identified in both the FRB and the CFA studies, without killing the golden goose? Solutions that appear to offer the greatest promise for boosting quality with the least risk of creating new problems fall into two categories.

The first and most important category would include measures to encourage greater consumer vigilance in examining their credit reports at all three of the major repositories. Despite the original FCRA's elevation of the consumer to a prominent role in quality control, this area seems to be the weak link in the current system's operation. As we have seen, comparatively few consumers access their credit reports and those that do tend to seek access only when making a major purchase requiring credit. In other words, there is precious little "preventive" inspection of credit reports. This could reflect confidence that inspection of a report will reveal no surprises, but it may also reflect lack of awareness of the importance of the credit report and the potential cost of errors. The recent success of online credit report and score education products being marketed to consumers is an encouraging sign that consumer awareness is growing. Nevertheless, the consumer's inspection of his/her own report remains the most underutilized of all the existing tools for promoting accuracy.

Proposals for expanding the conditions under which consumers would be entitled to free credit reports are one way to encourage consumer participation, but for reasons already discussed, they are unlikely to be the most cost-effective solution.[127] Effective appeals to borrowers' self interest can convey the importance of inspecting one's own credit report (e.g.,

[127] See the discussion at footnote 119 supra.

detect errors and pay a lower interest rate on loans). Coupled with an explanation of the substantial rights and opportunities of consumers to dispute inaccurate information, this approach seems more likely than the right to a free annual report to motivate consumers to request their report and find out what all the fuss is about. Facilitating on-line access and simpler dispute resolution mechanisms (as the major credit bureaus have already begun doing voluntarily) would also help. Our point is not to propose specific measures—clearly, this would require careful evaluation of the likely effectiveness and cost of each—but rather to emphasize the importance of encouraging consumers to play the critical role in promoting accuracy that Congress envisioned for them.

The second category of promising approaches to improving credit report accuracy includes measures to enhance the quality, timeliness, and comprehensiveness of the information furnished to credit bureaus. These steps would not compel reporting, but would lower the cost of providing data, and explicitly raise the cost of withholding. For example, the credit reporting industry and federal regulators could develop and urge furnishers to use less ambiguous codes in reporting public record information. Industry adoption of standardized reporting protocols has proved quite successful in the past. Congress could also amend the antitrust laws to allow the credit reporting industry trade association the flexibility to promote uniform reporting requirements and reciprocity agreements for all members, so as to more directly impose a cost on a furnisher who chooses to withhold data.

The current system in the United States under which furnishers voluntarily report information to competitive credit bureaus has proved to be extraordinarily successful. But the U.S. credit reporting system is sensitive to regulations which impose administrative burdens on furnishers, increase their liability, or otherwise raise the cost of participating in the system. Attempts to further enhance credit report accuracy must be examined closely to ensure that they don't do more harm than good by discouraging participation.

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