NAFCU

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On Behalf of The National Association of Federal Credit Unions

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Fair Credit Reporting Act

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Introduction

The National Association of Federal Credit Unions (NAFCU) is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU is comprised of approximately 900 federal credit unions -- financial institutions from across the nation -- representing approximately 24 million individual credit union members. NAFCU–member credit unions collectively account for approximately two-thirds of the assets of all federal credit unions. NAFCU and the entire credit union community appreciate this opportunity to participate in the discussion regarding the Fair Credit Reporting Act (FCRA) and its effects on America's consumers.

Historically, credit unions have served a unique function in the delivery of financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was recognized as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have no access to credit. Congress established credit unions as an alternative to banks and to fill a precise public need—a niche that credit unions fill today for over 82 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 USC 1752(1)). While nearly 70 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

> Credit unions remain totally committed to providing their members with efficient, low cost personal service; and,
>
> Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's approximately 9,600 federally insured credit unions serve a different purpose and have a fundamentally different structure, existing solely for the purpose of providing financial services to their members. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union —"one member, one vote" -regardless of the dollar amount members have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors. Unlike their counterparts at banks and thrifts, federal credit union directors, serve without remuneration — a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Credit unions have never cost the American taxpayer a dime. Unlike the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loans Insurance Corporation (FSLIC) – the precursors to Bank Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF) – that were started with seed money that came from the United States Treasury, every dollar that has ever gone into the National Credit Union

Share Insurance Fund (NCUSIF) has come from the credit unions it insures. And unlike the thrift insurance fund, credit unions have never needed a federal bailout.

America's credit unions have remained true to their mission of "promoting thrift" and providing "a source of credit for provident or productive purposes." In fact, Congress acknowledged this point when it adopted the *Credit Union Membership Access Act* (CUMAA – P.L. 105-219). In the "findings" section of that law, Congress declared that, "The American credit union movement began as a cooperative effort to serve the productive and provident credit needs of individuals of modest means … [and it] continue[s] to fulfill this public purpose."

Today, credit unions play an important role in the lives of millions of Americans from all walks of life. As the package of financial services offered by various financial institutions becomes ever more homogenized, the emphasis has begun to shift from types of service to quality and cost of service. Credit unions are second to none in providing their members with quality personal service at the lowest possible cost. According to the 2002 *American Banker*/Gallup Consumer Survey, credit unions had the highest rated service quality of surveyed financial institutions. This has held true each year since the survey was initiated -- a trend that shows no sign of changing.

As well as serving on the Board of NAFCU, I also serve as President and CEO of The Summit Federal Credit Union. The Summit Federal Credit Union is a multiple group credit union serving over 43,000 members nationwide. Most of the members are served out of five branch locations and the credit union headquarters in Rochester New York. Although there are approximately 41,000 members in New York, we do have at least one member in all 50 states including at least 100 members in seven states and at least 20 members in an additional seventeen states. Because of this there is a great likelihood that at any given point in time The Summit Federal Credit Union will have consumer loans outstanding in anywhere from 25 to all 50 states. Due to the different laws that exist on a state by state basis, The Summit does not engage in real estate lending outside of New York, but does extend credit for all other consumer purposes in all 50 states.

The Fair Credit Reporting Act

The foundation of America's national consumer credit system is the Fair Credit Reporting Act, enacted by Congress in 1970 to streamline credit reporting and provide consumers with protection from inaccurate and inappropriate disclosures of personal information by consumer reporting agencies. Consumer reporting agencies collect and compile information about consumers' creditworthiness from financial institutions, public records, and other sources. Today, millions of small and large businesses rely on consumer reporting agencies information to help provide services and products to consumers. Consumer reporting agencies in this country currently maintain credit files on more than 180 million adults and track more than two billion transactions per month.

The Fair Credit Reporting Act was strengthened in 1996 in response to consumers' concerns that businesses that provide information to the consumer reporting agencies were not being held accountable for their accuracy, and that consumer reporting agencies were unresponsive to consumer inquiries and disputes. As a result of these concerns, amendments were added to the bill to establish strong national operating standards intended to preserve the efficiencies of the credit reporting process while ensuring that its benefits extend to consumers across the country.

In 1996 the Fair Credit Reporting Act was amended and now contains seven specific federal preemptions to ensure that the national consumer credit system remains viable and can continue to deliver affordable and accessible credit and financial services to consumers. Federal consumer credit laws that apply nationally regulate the following areas and include provisions that preempt states from regulating or changing:

1. the responsibilities of organizations and businesses that furnish information to consumer reporting agencies;

2. the duties of organizations and businesses to notify consumers when they have been denied credit or employment based on information in their credit reports;

3. procedures that a consumer reporting agency must use if a consumer disputes the accuracy of information;

4. the information that may be included in consumer reports, including the time periods during which consumer reporting agencies are permitted to report adverse information;

5. the form or content of the summary of rights that a consumer reporting agency is required to provide to a consumer along with information in the consumer's file;

6. the exchange of information among affiliated institutions; and

7. prescreening activities to provide consumers with credit or other financial service or product offerings.

These provisions are set to expire on January 1, 2004 unless they are extended by Congress. NAFCU agrees with Federal Reserve Board Chairman Alan Greenspan and Treasury Secretary John Snow that Congress should permanently reauthorize the provisions of the Fair Credit Reporting Act. Reauthorizing these Fair Credit Reporting Act provisions will give credit unions the ability to continue to offer their members credit in a timely manner at a fair market price.

Reauthorizing these provisions of Fair Credit Reporting Act would also codify the ability of credit unions to share certain member information with their affiliates – thus giving credit union members the ability to obtain additional financial services of which they might be otherwise unaware. This law, combined with the privacy provisions of the 1999 Gramm-Leach-Bliley Act (P.L. 106-102), has gone a long way in protecting the privacy rights of America's consumers.

Failure to reauthorize these preemptions would drastically change the way a credit union is able to conduct business in today's financial marketplace. A credit union such as mine, with members in 50 states, could be forced to comply with fifty different state laws. As you may know, credit unions on average are small financial institutions and many may not have the resources necessary to comply with differing laws across the 50 states. They would, therefore, be forced to forgo lending in many states in which they have members. This would result in the potential of millions of consumers losing a viable lending option and may make smaller credit unions less competitive in today's financial marketplace.

National System Benefits

From law enforcement to child welfare enforcement agencies, a variety of public sectors rely on our national credit system to provide accurate and comprehensive consumer credit information.

Credit Unions and Banks: National and local credit unions and banks rely on the national credit system to assess lending risk, manage portfolios, detect fraud, acquire new members or customers and grow those relationships. Restricting access to this information would likely increase lending losses, driving up costs for consumers.

Employers: Information from the national credit system is a helpful tool for verifying an applicant's identity, reducing application fraud, and finding indicators of financial risk. In addition, this information is a valuable component of background checks for teachers, bus drivers, day care centers and others who children are entrusted to on a daily basis.

Utilities: Each year, more than 40 million Americans move to a new address and must sign up with new utility providers. These companies depend upon the national credit system for information on new customers' identities and to assess risk of non-payment.

Retailers: Without the national credit system, consumers could not apply for instant credit, and the application process for store loans for larger purchases would be longer, far more complex and result in fewer approvals.

Law Enforcement Agencies: Credit information is a critical tool for locating criminal and terrorism suspects and potential witnesses, identifying suspects or verifying their identities, and assisting in investigations.

Mortgage Brokers: This year, more than 6.5 million Americans will apply for new home loans, and millions more will refinance existing loans. The mortgage lenders and bankers processing these applications and making the loans use information from the national credit system to make sure loans are sound and to provide consumers with the best possible rates.

Internet Companies: Information from the national credit system allows companies to prevent fraud in online financial transactions by verifying and authenticating the identities of their customers.

Child Welfare Enforcement Agencies: The national credit system helps enforce child support payment by allowing missed payments to be added to a parent's credit report and providing information to help locate parents and enforce the law.

Automobile Dealers: Americans who are creditworthy are able to purchase automobiles within hours because dealers are able to rely on the national credit system to make risk decisions on "instant loans."

Wireless Communications: Americans are able to establish cellular phone service immediately when purchasing a new phone, because service providers are able to use information from the national credit system to instantly evaluate at the point of sale the risk that a consumer will not pay bills, to validate the content of the application and verify the identity of the applicant.

Credit Card Companies: More than 185 million Americans have credit cards, yet fewer than 3 percent make late payments each month. Credit card companies are able to keep this rate so low by using information from the national credit system to identify potential new customers, minimize lending risk, prevent fraud, manage customer portfolios and improve customer relationships and experiences.

Credit Union Consumer Lending Programs and the Use of Credit Scoring and Credit Reports

While it is true that many credit unions do a variety of lending, the vast majority of loans made by credit unions are consumer loans. As an industry, we are very good at making these loans, and our experience allows us to use the various tools that are available as well as our understanding of our members and communities to be successful.

Credit scoring and credit reports are critical to the operational needs of most consumer lenders, and they are critical to our credit union's operations. These items are two of the best active tools for evaluating the credit worthiness of borrowers, and coupled with experience and judgment, have allowed us to establish a very successful lending program at our credit union.

We feel strongly that credit scoring, credit reports, experience and judgment work together to contribute to good lending decisions. We have found that credit-scoring modules are statistically valid, and that the accuracy of credit reporting and credit scores are much improved over what they used to be. We also acknowledge that at times there are errors in credit reports, but we are pleased with the improvement that we have seen in recent years. And we have also found that many times well-trained credit officers can find these errors, and that credit decisions are in most cases made independent of these errors after an appropriate investigation.

Using Credit Reports

Certainly there are times when erroneous information appears on a credit report that just does not make sense. We rely on the experience, training, and judgment of the loan officer to detect these errors. One example might be a delinquent mortgage obligation when the member has indicated that he or she rents. Another may be when a person has clean credit and one bill that shows a delinquent repayment record, which is inconsistent with the rest of the report. These should be red flags for a loan officer and should be questioned immediately.

Another way that errors in credit reports are detected is through comparing discrepancies between the debts listed on a member loan application and those reported on a credit report. The credit union loan officers understand that some members simply forget to list all of their debts; we also realize that it is possible on rare occasions, that people with common last names or other similar characteristics can be mistaken for one another, and items can find their way onto other peoples' credit reports. The way to find these mistakes is simple. What we try to do is talk to the member. In a perfect world we can contact these people by phone, and they will be easily reached. This is not always the case, and at times we need to send a letter, possibly rejecting the loan, and wait for a response or appeal.

Errors aside, credit reports are VERY valuable tools as they serve to verify that a member has listed all his or her debts on a loan application, and these reports subsequently provide details as to the payment history on those debts. In this day and age, consumers have more credit lines at more places than ever, and it is very unusual that a member remembers to list all of his or her debts on an application, and further, the repayment history gives rise to some significant information about how responsible the member is in handling his or her obligations. More members than ever are opening credit lines with providers in multiple states. That said, it would be unreasonable for the requirements for reporting to be inconsistent from state to state. Allowing for a consistent method of credit reporting allows us to get the information that we need to have important conversations that are necessary to extend credit responsibly to our members. The current federal preemptions satisfy these needs, and we strongly urge that they be extended.

Credit Scores

Credit scores are another important tool that can be used in the extension of credit. The most important ways that credit scores are used include the automatic extension of credit and as a predictor of losses that could occur based upon a variety of factors that appear in the member's credit history. Some important facts about credit scores include:

1) Scores are developed solely on the member's own loan portfolio experiences. They are independent of race, income, religion, etc.

2) Scores help to forecast specific risk levels associated with individuals. On a national level, credit scores are as follows;
    a. 700 and above - 60% of population
    b. 650-699 – 16% of population
    c. 600-649 – 11% of population
    d. Under 600 – 13% of population

There are about 50 factors that contribute to credit scores, but the most important factors that contribute to credit score are as follows[1]:

1) Repayment History – 35% of score
    a. Payment information on specific types of accounts.
    b. Severity of delinquencies.
    c. Time since last past due item.
    d. Number of past due items.
    e. Number of accounts paid as agreed.

2) Amount of credit owing – 30% of score
    a. Includes amount due on loans.
    b. Amount on specific types of loans.
    c. Numbers of loan accounts with balances.
    d. Lack of a specific type of account in some cases.
    e. Proportion of balances due compared to original loan amounts.
    f. Proportion of credit lines used and capacity to borrow.

3) Credit History – 15% of score
    a. How long have you had credit.

4) New Debt – 10% of score

5) Credit Mix – 10% of score

Impact of Credit Scores

Credit scores can be used in several ways. At the Summit Federal Credit Union we use them as follows:

1) Automatic Approval - At The Summit Federal Credit Union we use credit scores to facilitate automatic approval of loans (no loan officer interaction), but do not use credit scores as an automatic rejection of loans. If a score is lower, it guarantees that the application must be reviewed and handled by a loan officer.

[1] U.S. News & World Report, February 5, 2001, Personal Finance: Credit Score Card

2) <u>Loan Rate</u> – We have used credit scores to predict risk and to assign loan rates for over five years, and have a significant statistical sample to use in the evaluation of the success of this program. Those members with higher scores will get lower loan rates. In general, members who have historically paid their debts, and managed credit well will get the best rates. We use a combination of our actual experience and national data for those borrowers with similar scores to set rate margins annually.

a. Loan Rates offered as of May 31, 2003:
   i. "A" Rates – 680 and up – best rate
   ii. "B" Rates – 660-679 – best rate + 1.00%
   iii. "C" Rates – 620-659 – best rate + 1.75%
   iv. "D" Rates – 580-619 – best rate + 3.00%
   v. "E" Rates – 580 and below – best rate + 8.00%

b. Statistically Valid – Our top scoring members have delinquent ratios, as follows;
   i. "A" rates – 680 + up – 0.13% Delinquency; 0.11% Charge Offs
   ii. "B" rates – 660-679 – 0.23% Delinquency; 2.11% Charge Offs
   iii. "C" rates – 620-659 – 1.65% Delinquency; 1.73% Charge Offs
   iv. "D" rates – 580-619 – 1.65% Delinquency; 3.75% Charge Offs
   v. "E" rates – under 580 – 20.29% Delinquency; 11.31% Charge Offs

Consumers and Credit Score

In general, people know that when they do not manage their debts properly, that fact will show up on their credit report and hurt their "credit rating". But, there is very little knowledge on the part of consumers regarding the existence of credit scores, how they are used in determining rates, and how they can be improved upon. Even lenders cannot tell consumers all of the specifics, as some of the information is proprietary. We have sent people from our staff to seminars, and we have passed such information on to our members in response to inquiries.

Ideally, we would like to establish a new program at The Summit Federal Credit Union to educate our members to some degree on their credit scores. Today it is only being done on a case-by-case basis as members ask for an explanation. Our vision is to educate staff and then to advertise the service.

Conclusion

NAFCU believes that the state of the credit union community is strong and the safety and soundness of credit unions is unquestionable. Nevertheless, we urge the Subcommittee to carefully assess this issue and reauthorize the preemptions included in the FCRA. We understand that there is much work to be done by the Subcommittee and we urge the Subcommittee to undertake a careful examination of what other measures fall within the scope of this legislation that will address the concerns we have articulated.

NAFCU thanks the Subcommittee for the opportunity to make this statement before you today and commends the House Financial Services Committee for examining these important issues. We look forward to working with you on this important piece of legislation and would welcome your comments or questions.