SUBCOMMITEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT OF THE HOUSE COMMITTEE ON FINANCIAL SERVICES

HEARING ON

"Keeping Score on Credit Scores: An Overview of Credit Scores, Credit Reports and Their Impact on Consumers"

March 24, 2010

Testimony of:

Myra Hart, PhD
Senior Vice President, Analytical Services
Equifax Inc.
1555 Peachtree Street, NW
Atlanta, GA 30309

INTRODUCTION

Chairman Gutierrez and members of the Subcommittee, I am Myra Hart, Senior Vice President of Analytical Services for Equifax Inc. I want to thank you for this opportunity to testify regarding credit scores and their impact on consumers. I would also like to express my appreciation to your staff for all their assistance in preparing for this hearing.

This statement briefly describes Equifax Inc.; describes what a credit score is; discusses benefits credit scoring provides to both consumers and lenders; and discusses Equifax's credit scoring models and scores. Given the focus of the hearing, my testimony focuses on scores and scoring models used by our lender customers, as opposed to scores used by others, such as insurers.

ABOUT EQUIFAX

Founded in 1899, Equifax Inc. is the oldest, the largest, and the only U.S. publicly traded of the national companies that provide consumer information for credit and other risk assessment decisions. My testimony primarily is focused on our Equifax Information Services subsidiary, which is our Fair Credit Reporting Act (FCRA)[1]-regulated credit reporting business, which for purposes of convenience, I will refer to simply as Equifax. As one of the three "national" credit reporting agencies, Equifax's activities are highly regulated under the FCRA and other related federal and state statutes. Equifax is a responsible steward of sensitive consumer information and, as such, is committed to consumer privacy. We actively work with governments, consumers, and businesses to forge effective solutions to complex information and privacy issues. Equifax believes that the marketplace can offer solutions that enlighten, enable and empower consumers.

WHAT IS A CREDIT SCORE?

A credit score, broadly speaking, is an analytical/statistically based methodology used to objectively assist in the prediction of consumer credit behavior. Credit scores allow lenders to project future account behavior more precisely, allocate their resources more efficiently, and minimize risk throughout the life cycle of an account. Credit scores may be used in connection with a variety of purposes, such as opening new accounts, determining down payment or deposit amounts, establishing and reviewing credit limits, and prioritizing collection efforts. Lenders can obtain scores based on credit scoring models developed by third parties, such as Equifax or Fair Isaac, or they can develop their own scoring models and obtain credit reports from Equifax (or other consumer reporting agencies) to which those scoring models are applied.

Credit scores are tools that lenders can use to assist in evaluating a consumer transaction or an account. Any decisions – such as whether to lend to a borrower or what terms to offer the borrower – are made by the lender, not those creating the scoring model or supplying credit information for use in the generation of the credit score. Lenders determine the role credit scores have in their credit risk decisions. For example, in the case of a mortgage loan, credit scores are

[1] 15 U.S.C. Sec. 1681 *et. seq.*

not the sole factor in their decision as other factors, such as the value of the property, loan to value ratios, the size of the down payment, and the consumer's debt to income ratio commonly would be considered in a lender's decision. Three lenders obtaining the same credit score on the same day could chose to offer the consumer different loan products or rates depending upon their underwriting decisions.

BENEFITS OF CREDIT SCORES TO CONSUMERS AND LENDERS

Credit scoring systems provide benefits for consumers, for lenders, and for the economy. According to the Federal Reserve Board, "the introduction of credit-scoring systems has increased the share of applications that are approved for credit, reduced the costs of underwriting and soliciting new credit, and increased the speed of decision making." Examples of other benefits of credit scoring, also identified in the Federal Reserve Report, include:[2]

- Credit scoring increases the consistency and objectivity of credit evaluation and therefore may reduce the possibility that credit decisions will be influenced by personal characteristics or other factors prohibited by law.
- Credit scoring increases the efficiency of consumer credit markets by helping creditors establish pricing that is more consistent with the risks and costs involved.
- Credit scoring has broadened creditor access to capital markets, thereby reducing the cost of funding loans and strengthening public and private scrutiny of lending activities.
- Credit scoring has promoted competition between lenders by making it possible for creditors to readily solicit business from their competitors.

CREDIT SCORES OFFERED BY EQUIFAX

Equifax markets third-party credit scores, such as the VantageScore, of which Equifax shares partial ownership.[3] Equifax also has developed scoring models of its own, such as the Equifax Risk Score^{sm}. Equifax Risk Score is a general purpose risk model that predicts the likelihood of a consumer being seriously delinquent.[4] Also, as noted above, many customers choose to develop their own scoring models and then obtain consumer credit reports from Equifax to use with their own models in connection with the lender's credit determinations. As we understand that Fair Isaac, developer of the FICO score, has been invited to testify at today's hearing about its scoring models, we will focus our testimony on a description of our own scoring models.

Equifax has developed hundreds of customized credit models for use by its customers. These models pivot off of criteria, metrics, and goals provided to Equifax by our customers. Equifax credit scores predict the likelihood of a particular behavior by a consumer, such as payment, delinquency, or bankruptcy, within a set time period. Of course, Equifax credit scores are not a guarantee that a defined behavior will occur.

---

[2] Board of Governors of the Federal Reserve System, "Report to the Congress on Credit Scoring and its Effects on the Availability and Affordability of Credit: Submitted to the Congress pursuant to Section 215 of the Fair and Accurate Credit Transactions Act of 2003" (Aug. 2007). pp. O-4 – O-5.

[3] VantageScore is an alternative to the FICO score created by Equifax, Experian, and TransUnion.

[4] "Seriously delinquent" is defined as 90 days past due, including charge-off, repossession, foreclosure, bankruptcy and other major derogatory events.

Equifax credit scores are mathematically and statistically-derived and correlated to actual historical behavior or performance. Scores are consistent, objective, and free from bias. Scores are an alternative to judgmental decision making, which typically is based on the experience of the decision makers, may be influenced by professional intuition, and can be biased or influenced by emotional states or consideration. Regulation B,[5] which implements the Equal Credit Opportunity Act,[6] addresses creditor use of credit scoring models and the development and validation practices that distinguish what the Regulation refers to as an "empirically sound, demonstrably and statistically sound" credit scoring system from judgmental assessments of applicants.

Equifax credit scoring models typically assign higher scores to consumers who exhibit a high likelihood of exhibiting the consumer behavior the credit scoring model is developed to predict. For example, with a credit scoring model developed to predict the likelihood of a consumer paying the account as agreed, a high credit score indicates a high likelihood of satisfactory repayment performance, i.e. the consumer paying the account as agreed. Conversely, lower credit scores would indicate a likelihood of low or unsatisfactory performance. Our scores potentially are based on hundreds of discrete factual items of information in the credit file, which can be broadly grouped into categories, commonly referred to as "attributes", such as payment history, amounts owed, length of credit history, new credit account activity, and the types of credit used (installment, revolving, etc.). Equifax does not use information about gender, race, color, national origin, marital status, religion, or address as attributes in its credit scoring models.

The weighting of particular attributes varies from model to model depending upon the customer's (user's) goals and how that attribute impacts the type of behavior or outcome that the scoring model is seeking to predict. Equifax offers both custom and generic credit scoring models. A "generic" credit score is derived from a scoring model that has been developed on the basis of information from a sampling of the general population. A "custom" credit score is a score that is based on scoring model that has been developed on the basis of a sampling of a more specific population, such as a specific lender's customers.

Equifax credit scores are based on information in a consumer's Equifax credit file, which is subject to the full range of standards, rights, and protections, afforded by the FCRA. Information used in scoring Equifax credit scoring models may include tradeline information regarding a consumer's credit accounts (such as the type of account, the date the account was opened, the credit limit or loan amount, the outstanding balance, and the consumer's payment history); certain inquiry information; and public record or collection information such as certain judgments, tax liens, bankruptcies and third-party collection account information. For the Equifax Risk Score, Equifax does not score files in cases where the consumer's file either has no tradelines, no tradeline that has been open for more than six months, or no tradeline that has been updated within the last six months. Credit reports also include identifying information about consumers, but this information is not used as attributes in a credit scoring model.

---

[5] 12 C.F.R. Part 202.

[6] 15 U.S.C. Sec. 1691 *et. seq.*

Information that may be predictive of creditworthiness, other than the information customarily found in the traditional credit report, often are commonly referred to as "alternative data." Alternative data sources might include, for example, utility payment history information, telecommunications history information, rental payment history information, or checking and savings account information. Legal and other barriers create challenges for collecting this information. The use of such information (once collected and reported in traditional credit files) in credit scoring models, based on traditional credit files, would require continuing study, looking both at its content and its impact on current, traditional credit scores. Equifax already provides some types of alternative data as a service provider to many telecommunications and utility companies, and Equifax is committed to developing additional sources of alternative data so as to assist further in "thin-file" and "un-banked" consumers.

CONCLUSION

Thank you again for the opportunity to testify on these important issues. The advent, proliferation, and popularity of automated decision-making through credit scores has had a profound and comprehensive impact on the credit process. Making credit decisions using credit scores has made the process faster, more objective, and based on consumer merits (i.e. a repayment record that the consumer has earned). Increased efficiency in the credit process allows for increased accessibility to credit for low and middle income and minority populations. Credit scores are an effective, usable risk management tool for financial institutions to improve the safety and soundness of their lending practices, which benefits consumers, lenders, and the economy. Equifax looks forward to continuing to work with the Subcommittee on scoring issues and educating consumers as to what they need to know, as borrowers, about credit scoring models and credit scores.

BIOGRAPHY

Myra Hart currently holds the position of Senior Vice President for Analytical Services at Equifax, where she manages Analytical Consulting and is responsible for designing and delivering decisioning solutions that span the customer lifecycle for financial services, telecommunications, retail and insurance clients. After completing a PhD in Economics at the University of Iowa, Myra began her career as an Assistant Professor of Economics at Whittier College. Since then, Myra has built more than 15 years of experience in customer segmentation, scorecard development and implementation, database marketing, credit strategy and policy and econometric analysis while holding positions of increasing responsibility at First Chicago Bank, Bank One/First USA and Equifax.