STATEMENT OF

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Before the

Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

U.S. House of Representatives

March 24, 2010

I. Introduction

I'd like to thank Chairman Gutierrez, Ranking Member Hensarling and Members of the Subcommittee for the opportunity to submit testimony for the record and provide information about how credit scores are developed and used. My name is Stan Oliai, and I am Senior Vice President of Experian Decision Analytics.

I'd like to start with a brief background about Experian. With our North American headquarters in Costa Mesa, California, Experian currently operates in 65 countries with more than 15,000 employees worldwide. The company helps organizations to manage credit risk; detect and prevent financial fraud, including identity theft; and better understand how to serve their existing customers and reach new consumers. Experian also helps consumers improve their financial literacy by allowing them to check their credit report and credit score, and protect themselves against identity theft.

Experian is well known in the United States as one of the three national credit reporting agencies. But credit reporting is only one side of our business. In fact, we have a family of companies that are tied together by their focus on consumer data. Combined, these companies make Experian a global leader in providing information, analytical tools and marketing services to organizations and consumers to help manage the risk and reward of commercial and financial services. I am here today to represent one of those business units, Experian Decision Analytics. Our business serves as one of the world's largest providers of software for credit scoring, fraud detection and risk-based pricing.

Credit scores are prominent in today's economy as most lenders use a score to estimate the relative risk that a consumer presents in repayment of a loan, as well as to price financial products accordingly. As we've seen the use of credit scores increase, they have provided tremendous benefits for both business and consumers. The use of credit scores for risk-based pricing has led to significant increases in efficiencies in the market. Consumer benefits include less cross-subsidization of risk, lower prices, increased compliance with the Equal Credit Opportunity Act, less bias in decision-making, more available capital and real-time lending decisions. Yet despite these benefits, the process is often not fully understood or appreciated.

II. The Role of Credit Reporting Agencies in the Lending Decision Process.

There is often confusion surrounding the role of the credit reporting agency in the lending process. It is worth clarifying one key fact: credit reporting agencies do not make lending decisions; only lenders can do that. Neither companies that develop credit scores, nor credit reporting agencies that deliver information to scoring models participate in actual lending decisions. We simply are not in a position to testify as to how scores are weighted or what other information besides a score is considered when a lending decision is made.

Credit reporting agencies do provide credit reports and can generate a credit score at the request of the lender from a model chosen by a lender. These credit scores help lenders make lending decisions. However, a credit score is simply one of a variety of analytical tools lenders can use to make a decision. Each lender has its own proprietary underwriting process and uses information from multiple internal and external sources when making a lending decision. The volume of information sought would depend on many factors, from the type of loan being offered (i.e. revolving line of credit vs. mortgage) to the type of collateral for the loan (i.e. year and model for an auto loan vs. similar sales records for real property). A credit score alone in any of these situations would not and should not be the sole determining factor for the extension of the loan, but would be balanced against other information included in the consumer's application or obtained by the lender.

III. What Are Credit Scores and how are they Calculated?

A credit score is simply a numerical expression of risk of default produced by a mathematical formula or model. A credit score formula is created based on a statistical analysis of a large, representative sample of historical credit files. There are numerous credit models in use today.

A credit score predicts the relative likelihood that the person will pay his debts in a timely manner. Information used in calculating a credit score comes from an individual's credit file and generally includes credit account history (was the account paid, was it paid on time, how long has the account been open, what is the outstanding balance, etc.), type of account (revolving, installment, mortgage, etc.), public record information (liens, judgments, bankruptcies) as well as those inquiries in the credit file that represent applications for new credit or other consumer-initiated transactions. A credit file does not include information such as income or assets, and does not include demographic information such as race or ethnicity, and those factors are not used in credit risk scores. As I mentioned earlier, many other factors, not reflected in a credit report or credit score, go into the underwriting process, such as income, collateral value, debt to income ratios and the like. Each lender decides its own risk tolerance.

Many consumers might think they only have three possible credit scores: one from Experian, one from Equifax and one from TransUnion. In fact, a consumer could have many different scores, depending on the lender. Each lender can develop its own in-house "custom" score or select a model developed by a third party, such as Experian, that reflects the individual lender's own level of risk tolerance and control for different risk factors. There are many vendors offering different scoring models aimed at different types of risk. For example, one lender's risk model may see one 60-day late payment as acceptable, while another would not. Or, another lender may acquire a third-party score aimed at determining whether a person is likely to be progressing toward bankruptcy.

Experian and other model developers design credit score models that are "empirically derived, demonstrably and statistically sound," as required by Regulation B. Regulatory oversight of credit scores is accomplished through routine bank examinations for compliance with a number of laws that govern fair lending, such as the Equal Credit Opportunity Act. This makes sense, because a credit score is a model chosen by a lender to assist in its proprietary underwriting process. The lender is ultimately responsible for demonstrating to regulators that the scoring model it has chosen to use complies with lending laws.

IV. How Consumers Can Obtain a Credit Score

A consumer can obtain a free disclosure of the credit report from www.annualcreditreport.com. While obtaining an Experian credit report through that website -- or at any time through www.experian.com -- a consumer can obtain their VantageScore for $5.95. This price has not changed since the enactment of FACTA. Since Experian believes it is in the consumer's best interest to acquire the credit report and score at the same time, we offer a combined package for $15. This way, consumers are able to better understand how the score and accompanying reason codes actually relate to the data in the credit report.

In recent years there have been questions surrounding the cost of a credit score, with some suggesting that nationwide consumer reporting agencies should provide a free credit score to consumers when they request their credit report at www.annualcreditreport.com. At the heart of this discussion is a question of fairness for the company that developed the software to produce a score. Without software, a credit score would not exist. Therefore, this software is the intellectual property of the company that developed the scoring software. Significant investments are made in developing, maintaining, updating and marketing the credit score model. First, a developer must purchase de-personalized credit history and then, employing a highly-technical workforce to statistically analyze the credit histories, determine how predictive each factor in a file is on future behavior and risk.

Imagine the outrage at the suggestion that a company that develops software for tax filings, for example, to be required to give away its intellectual property.

The Federal Trade Commission (FTC) looked at the issue of the price of credit scores sold directly to consumers by credit reporting agencies in the rulemaking subsequent to the enactment of the Fair and Accurate Credit Transactions Act of 2003. In the Advanced Notice of Proposed Rulemaking (ANPR) of the Fair and Reasonable Fee for Credit Score Disclosure, the FTC observed that "[i]f the fee is set too low it may discourage competition on other terms of the transaction…such as quality, service, or willingness to innovate."[1]

Further, with so many scores being used in the marketplace, a legitimate question is which score should be disclosed. Some would suggest that the "dominant" score be disclosed. However, it must be understood that there is no single dominant score being used by all lenders and that a consumer reporting agency does not own a credit score it has not developed itself. Therefore, requiring a credit reporting agency to disclose a score that it has not developed itself would not only affect the agency's revenues as a result of lost sales, but would also require an agency to pay a royalty to the owner of whatever "dominant" score Congress might prescribe.

In addition, the FTC observed in the 2004 ANPR, that if the FTC were to regulate the price of credit scores, it would only be the scores sold by national credit reporting agencies. That would leave other companies selling credit scores to consumer that would not be affected, such as other score developers, specialty consumer reporting agencies and even financial institutions. The FTC concluded that "a fixed price may place regulated sellers (i.e. national credit reporting agencies) at a competitive disadvantage to unregulated sellers."

[1] Federal Register 64698 - 64702, November 8, 2004

The Federal Reserve has also weighed into the availability of credit scores when it recently approved the Final Rules on Risk-Based Pricing Notices. The final rule requires a creditor to provide a consumer with either a notice or a credit score disclosure, including information about their score when credit is provided on less favorable terms than is provided other consumers. When supplying a credit score, a creditor must provide a statement that includes language educating customers that "a credit score is a number that takes into account information in a consumer report and that a credit score can change over time to reflect changes in the consumer's credit history."[2] The Federal Reserve has indicated that a score disclosure is important and the most meaningful when a consumer is faced with a credit decision.

V. How Consumers Maintain a Good Score

One of the greatest misconceptions regarding credit scores is that there are fast and easy tricks a consumer can engage in to improve a score. This is simply not the case. This misinformation is typically perpetuated by credit repair clinics and other similar organizations. Some of these "tricks" include: closing unused credit accounts, becoming an "authorized user" on another's credit card, and disputing accurate information in the hopes of getting it removed.

While misleading information abounds, the truth is that a bad credit score derived from a credit report with accurate but derogatory information cannot be cleaned-up overnight, despite promises to the contrary. A bad credit score was not created overnight and it cannot be quickly "fixed" with a few simple changes. Improving one's credit score requires time and diligence in changing one's credit behaviors. While these changes are

[2] Federal Register 2724-2784, January 15, 2010

simple in theory, the application can often prove challenging. Simply put, the best way to "fix" one's credit score involves paying bills on time and keeping the debt to available credit ratio reasonable.

VI. Benefits of Credit Scoring

Credit scores provide a measurable benefit for consumers and a marked improvement over the old process that required every consumer to be subject to a manual review and judgmental decisions. A credit score is calculated strictly based on the information in the credit file, limiting potential subjectivity on the part of a lender. Credit scores promote consistency in decisions, as the same formula is applied evenly to every consumer's credit file. In fact, for this reason, automated credit scoring leaves much less opportunity for discrimination than a potentially subjective assessment by a lender. Credit scores are blind to the factors protected by the Equal Credit Opportunity Act, which include race, color, religion, national origin, sex, marital status, or age.

Credit scores also have other benefits for consumers. Scores allow for lending decisions to be made accurately, efficiently and in a time frame convenient for consumers. For example, while consumers may not realize it, credit scores allow for quick decision-making in the purchase of a new automobile. When a consumer goes into a dealership, they can drive off the lot with a new or used car even though they do not know anyone at the dealership. Because of automated credit scoring, the bank could pre-approve the consumer quickly for a loan amount before they even enter the dealership. Alternatively, the dealership could also approve the consumer for financing that afternoon.

VII. Alternative Data and Credit Scores

Another issue I would like to address is that of alternative data and credit scores. Questions have been raised by policymakers, consumers and lenders as to what could be done to help more low-income groups and recent immigrants develop a credit history allowing access to credit, financing and mortgages. Many lower-income Americans either do not have access to credit, or choose not to utilize traditional lenders that report information to the credit reporting agencies. As a result, credit reporting agencies are not able to produce a credit score for these consumers that would help them transition to traditional lender services. One solution Experian is pursuing is to work with "alternative" credit data sources, specifically utilities and telecommunications providers. These alternative sources of data can provide information that is reliable in a similar way as traditional credit history data in evaluating risks to lenders. For example, indicators that show that individuals pay monthly utility bills on a timely basis can be used to develop reliable scores that may provide lenders with information they previously did not have, but that is sufficient to assess the risk of a loan.

While there could potentially be many different sources for alternative credit data, utilities and telecommunications are generally a form of credit services utilized by almost all consumers and therefore are a potentially very important and consistent source of information. A recent study by PERC (the Political and Economic Research Council) found that fully reporting energy utility and telecommunications customer payment data to consumer reporting agencies would help 70 million Americans gain access to affordable mainstream sources of credit.

It would be immensely beneficial to consumer reporting agencies, potential alternative credit data furnishers, low-income consumers and lenders if Congress clearly encouraged or endorsed the use of such data for these important uses.

VIII. Conclusion

I hope that my testimony today helped to dispel many of the myths surrounding credit scores. Credit scores remain one of the great advancements in consumer lending, and represent enormous opportunity for both consumers and lenders. Experian works hard to ensure that we have the most accurate and up-to-date credit information possible. We do this so that consumers are assured that their credit scores will serve as a useful tool in helping them to obtain the credit they need and deserve. Credit scores remain one of the best and most efficient ways of assessing a consumer's credit habits, and I hope that my testimony today will help the Committee to consider the importance of credit scores to the lending process.