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Written Testimony
before the U.S. House of Representatives
Committee on Financial Services

"A Biased, Broken System: Examining Proposals to Overhaul Credit Reporting to Achieve Equity"

June 29, 2021

Thank you, Chairwoman Waters, Ranking Member McHenry, and Members of the Committee for the opportunity to testify today.

My name is Amy Traub and I am Associate Director of Policy and Research at Dēmos. Dēmos is a dynamic think tank that powers the movement for a just, inclusive, multiracial democracy and economy. One of our core principles is economic democracy: The idea that "we the people" must be able to exercise real power over the economic decisions that shape our lives. We focus on Black and brown communities that have been largely excluded from economic decision-making. Economic exclusion is particularly clear in the case of the nation's credit reporting system.

In my testimony this morning, I will make the case that credit reporting is part of our nation's infrastructure, necessary to full economic participation and thriving for people and families nationwide. I'll share evidence of the systemic racial inequity in credit reporting and will show that the many failures of the system arise from the structure of the industry—and thus require structural change. Finally, I'll argue that publicly controlled credit reporting offers the best opportunity to rebuild the system and ensure that it operates in the public interest and promotes racial equity.

Dēmos welcomes the introduction of the National Credit Reporting Agency Act, which would shift power to consumers by enabling them—for the first time—to opt out of the flawed private credit reporting system and to choose a fairer public option. We look forward to working with the Committee to further strengthen this bill. We also support the Comprehensive CREDIT Act and urge Congress to enact this legislation, which would directly reform private credit reporting.

Credit Reports and Scores Determine Access to Economic Opportunity

Credit reports and scores play a large role in determining Americans' access to economic security and opportunity: A consumer's creditworthiness as evaluated by the credit reporting industry determines how much she will have to pay each month in interest on credit cards and other debt, and whether she can buy a car, be approved for a mortgage, rent an apartment, get a loan to start a business, or even secure employment. Consumers cannot opt out of having personal data about their borrowing and payment activities collected and evaluated unless they are willing to exclude themselves from the mainstream of economic activity. At the same time, the financial, real estate, auto sales, and a wide range of other industries rely on the credit reporting system to assess consumer risk.

The credit reporting system is a gatekeeper to a broad range of economic opportunities for consumers and commercial opportunity for businesses. Legal scholar and former Dēmos President K. Sabeel Rahman defines infrastructure as encompassing "goods and services, which together operate at scale, enable widespread downstream uses, and thus serve as foundational necessities for economic and social life."[1] Viewed through this lens, consumer credit and credit reporting are core parts of our nation's financial infrastructure. Yet this privately controlled infrastructure is failing consumers.

The Credit Reporting System is Failing American Consumers

My fellow witnesses will detail the ways that our biased, broken credit reporting system is failing American consumers. They will describe the outrageous inaccuracy of credit reports;[2] the nightmare process of getting errors corrected;[3] and the failure to invest in security for our most personal financial information—a failure that has resulted in massive data breaches.[4] They will document the traps credit reporting companies use to lure consumers into paying for what is, by law, a free credit report[5] and will show how personal credit information is being used for purposes far beyond the original context of consumer lending.[6] It is clear why credit reporting is consistently among the greatest sources of complaints to the Consumer Financial Protection Bureau.[7]

All of these failures of credit reporting must be addressed, but the most devastating failure is the way that credit reporting reproduces and spreads racial inequality, hindering efforts to achieve a truly equitable economy. Although credit scores never formally take race into account, they draw on data about personal borrowing and payment history that is profoundly shaped by generations of discriminatory public policies and corporate practices that limited access to wealth for Black and Latinx families.[8] Discrimination in employment, lending, education, and housing have produced significant racial disparities in credit history so that today, credit scores and other lending algorithms disproportionately represent Black and Latinx loan consumers as "riskier" than white consumers.[9]

One recent study finds that 1 in 3 Black consumers has a FICO credit score below 620, twice the rate of white consumers.[10] Meanwhile, a majority of white consumers have a FICO score above 700, compared to just 20 percent of Black consumers.[11] Black and Latinx consumers are also more likely than white consumers to be "credit invisible" or lacking in documented credit history.[12] As a result, whenever credit data is used in decision-making it multiplies inequality. Transforming credit reporting is far from the only step needed to address racial economic inequity, but it is one powerful tool to disrupt the cycle of disadvantage.

The Credit Reporting System is Public Infrastructure, Yet Is Dominated by Private Interests

Although the vast majority of American consumers rely on credit reporting to access economic opportunity, the credit reports of more than 200 million Americans are controlled by just 3 private companies: Equifax, Experian, and TransUnion. As private corporations, the aim of the credit reporting agencies is to generate profit, which they do by extracting, packaging, and selling data about consumers' personal borrowing and payment activity. Since consumers are not the customers of the private credit reporting agencies, they have no market mechanism to demand accountability or fairness: Consumers cannot opt out of the system or choose to work with a competing company. In effect, by controlling credit data, the 3 credit reporting agencies have consumers at their mercy—they have arbitrary, unaccountable power over our financial destinies.

The oligopolistic structure of the credit reporting industry is the reason it is biased, broken, and failing American consumers. The many problems we will discuss today—from the high error rate to the dismal reality that credit reporting reproduces and spreads patterns of racial inequality—all stem from the fact that credit reporting is part of our public infrastructure that is under a stranglehold by 3 private companies. Congress can and should continue to regulate the industry: The Comprehensive CREDIT Act is a powerful bill that addresses many of the harmful outcomes of the system and Dēmos supports this legislation. Yet without tackling the flawed structure of the industry itself, Congress and regulatory agencies will always be playing a game of catch up with a private industry that has no built-in incentives for accountability to the consumers whose financial fate it shapes. This is why Dēmos has proposed a public credit registry with the public interest at its core. I will briefly describe Dēmos' concept for the public credit registry.

A Public Credit Registry Is Needed to Serve the Public Interest

Dēmos has proposed establishing a public credit registry housed in the Consumer Financial Protection Bureau.[13] Under our plan, the publicly run credit registry would gradually replace the current for-profit corporate system and is designed to address the structural flaw in the credit reporting industry. By design, the public credit registry will be responsive to consumer needs and equity concerns rather than the corporate bottom line. The public credit registry will develop algorithms that diminish the impact of past discrimination, deliver transparent credit scoring, provide greater data security, and offer a publicly accountable way to resolve disputes. The use of credit information for non-lending purposes, such as employment, housing, and insurance, will be curtailed.

I will describe how the public credit registry will improve equity, transparency, accuracy, accountability, appropriateness, security, and public understanding of credit information compared to the current private system.

- **Equity:** The public credit registry will seek public input to develop new algorithms for predicting creditworthiness with a goal of minimizing disparate racial impact. New credit reporting algorithms could draw on alternative data sources (beyond lending), when these data have been shown to be predictive and to minimize racial disparities. Data sources could include allowing consumers to opt into reporting bank account cashflow data, rental payments, or utility data in order to have a more full and fully representative credit file. It is important that these data sources be opt-in rather than mandatory because of equity considerations relating to each source of data.[14] In addition to drawing on new data sources, the public credit registry will research proposals to exclude certain adverse credit data from credit reports and scores, for example, medical debt or payment delinquencies on predatory loans. The public credit registry will reduce the amount of time that adverse credit information remains on a credit report from 7 years to 4 years.

- **Transparency**: The algorithms used to determine creditworthiness will be publicly available with clear explanations of what consumers can do to improve their credit. Whereas the algorithms that determine credit scores are currently trade secrets owned by private companies, public access to algorithms will enable consumers to understand exactly how actions like paying a bill late or taking out a loan will affect consequential determinations about their financial futures. This transparency shifts power from secretive companies to consumers themselves. Credit reports and scores, which are entirely based on data about consumers' own behavior, will be free to consumers at any time.

- **Accuracy:** Lenders and other companies that furnish consumer credit data to the public credit registry will be held accountable for providing accurate information. The CFPB will impose fines on companies found to consistently furnish inaccurate or incomplete information. At the same time, the public credit registry will use the most robust methods available to ensure that credit information is accurate, including matching information to a consumer based on the full name of the consumer plus either the consumer's full date of birth or the consumer's Social Security Number or Individual Taxpayer Identification Number.

- **Accountability:** Consumers will have a right to dispute inaccurate information on their credit report and will be provided free copies of any documents used by the public credit registry to ascertain the accuracy of a disputed item. Consumers will have the right to appeal the results of a dispute and provide additional evidence. As a last resort, consumers will have the right to sue the public credit registry for a failure to fulfill its responsibilities.

- **Appropriateness:** The public credit registry will limit the use of credit information, preventing misuse in areas beyond the original purpose of lending. Credit information will only be provided for lending purposes, not employment, housing, or insurance. The federal government may not use credit information to make decisions about immigration status or for any purpose other than lending. Credit information will not be shared with any other government agency.

- **Security:** While no electronic data is 100 percent secure, the public credit registry's ultimate accountability to American consumers will provide a greater incentive to enhance data security compared to the private credit reporting agencies, which so far have faced minimal consequences for even the most severe data breaches.[15] Americans already trust their government with extensive personal financial information through the Internal Revenue Service, which has a strong record of data security. As an additional safeguard against fraud and identity theft, all personal credit information will be frozen by default, meaning that prospective lenders will be unable to access consumer credit data without prior authorization from a consumer. There will be no charge to consumers for removing credit freezes or placing new ones on their credit information.

- **Public awareness**: The public credit registry will fulfill the CFPB's mission of educating consumers about credit products and how to develop and maintain a good credit score. The public credit registry will also provide free or low-cost credit counseling and credit rehabilitation services, through contracts with licensed non-profit organizations that already provide these services.

The Transition to a Public Credit Registry
According to Dēmos' proposal, the public credit registry will be established as a function of the Consumer Financial Protection Bureau. Over a period of 7 years, all consumer credit reporting will shift from the private credit reporting agencies (CRAs) to the public credit registry. The 7-year transition period allows the public credit registry to amass sufficient data on consumers to fully replace the private, for-profit CRAs. As soon as the public credit registry is launched, any furnisher of data that currently reports to any private CRA will also be required to report data to the public agency. Consumers will be able to immediately opt out of having their credit data furnished to private CRAs. Private CRAs and furnishers of credit data will be required to report the age of all accounts to the public credit registry, so that the positive credit history of long-time payers can be reflected in the public registry's records. During the transition period, prospective lenders seeking credit information could continue to consider data from the private CRAs in making lending decisions, but lenders would not be permitted to discriminate against prospective borrowers who have opted out of reporting to the private CRAs. After the public credit registry has collected consumer credit data for 7 years, lenders will only be permitted to consider data from the public credit registry to make lending decisions—lenders will no longer be allowed to consider data from private CRAs or any other private source.

Many countries in Asia and Europe have public credit registries, although these are primarily oriented toward ensuring the stability of lenders, not the benefit of consumers. The United States will be a pioneer in establishing a consumer-oriented public credit registry that also benefits lenders through its greater accuracy, predictiveness, and public perceptions of fairness.

Dēmos Welcomes the Introduction of the National Credit Reporting Agency Act
The National Credit Reporting Agency Act creates a public credit registry as an alternative, rather than a replacement, for the corporate-dominated credit reporting system. A public option for credit reporting has the potential to shift power to consumers by enabling them—for the first time—to opt out of the flawed private credit reporting system and to choose a public system with strong mechanisms to promote equity, transparency, accuracy, and accountability.

We particularly value this bill's creation of an advisory committee on new credit scoring models. The committee would bring together a wide range of stakeholders in the credit reporting system, including consumer advocates, academics, lenders and other members of industry, as well as consumers who are directly affected by credit reporting errors, predatory lending, and other harms of the current system, to evaluate proposals for new credit scoring models, with the aim of both maximizing predictiveness in loan repayment and minimizing disparate impact by race, gender, disability or other protected categories. Building on the input of the advisory committee and following public hearings, the public credit registry would adopt a new credit scoring model, publicly available on the agency website, along with plain-language explanations of what factors contribute to improved or impaired credit and what consumers can do to improve their credit.

The National Credit Reporting Agency Act works best as an adjunct to the Comprehensive CREDIT Act, whose reforms of the private credit reporting system—including improving the dispute process, guaranteeing free credit scores, and banning the inappropriate use of credit information for employment purposes—would remain critically important as long as the private system continues to exist.

In Conclusion

The credit reporting system is part of our nation's financial infrastructure, necessary to Americans' financial flourishing, yet this critical system is failing consumers and is one of many economic and political systems putting Black and brown consumers at a disadvantage. What's more, the many failures of the credit reporting system arise from the structure of the industry, where the 3 corporations that dominate the industry have no business incentive for accountability to the consumers whose financial fate they profoundly influence.

Dēmos strongly supports the Comprehensive CREDIT Act, which would address many of the worst outcomes of the broken system. Yet this legislation does not change the underlying incentive structure of the industry, which is inimical to the interests of consumers. This is why Dēmos has proposed a public credit registry with the public interest at its core. We welcome the introduction of the National Credit Reporting Agency Act and look forward to working with the Committee to further strengthen and improve this bill.

Thank you and I look forward to your questions.

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