



Over the Horizon: *Consumer Credit After the Crisis*

**NAAG Presidential Initiative
April 12, 2011
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Overview

The extent to which consumers participate in the recovery will depend crucially upon their credit score—presenting a consumer-protection enforcement challenge for federal and state officials.

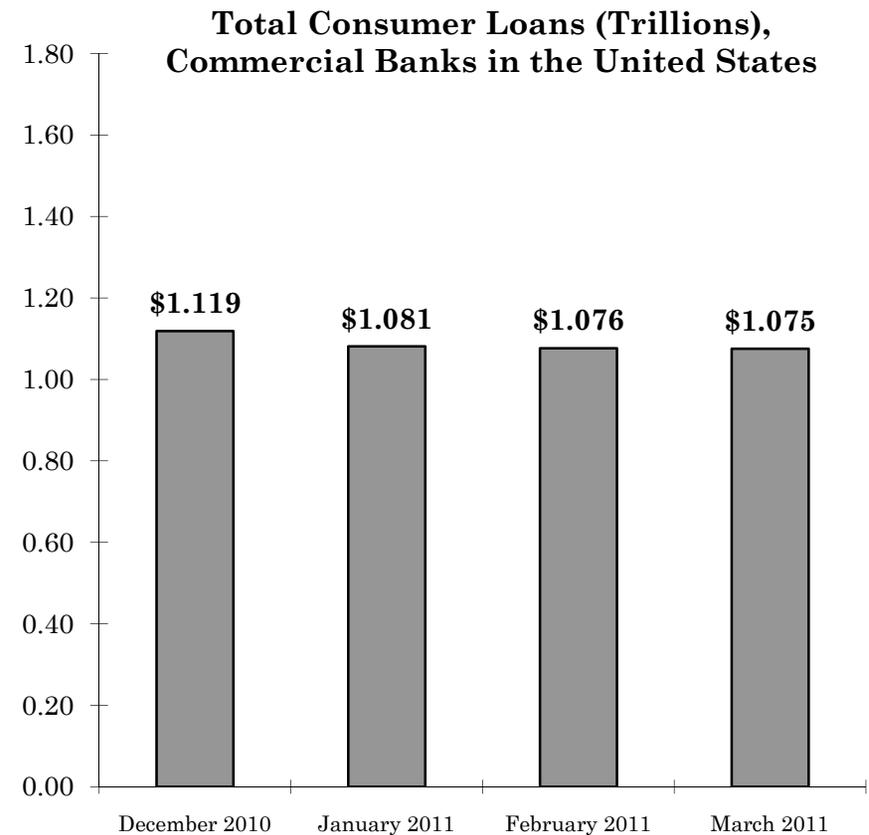
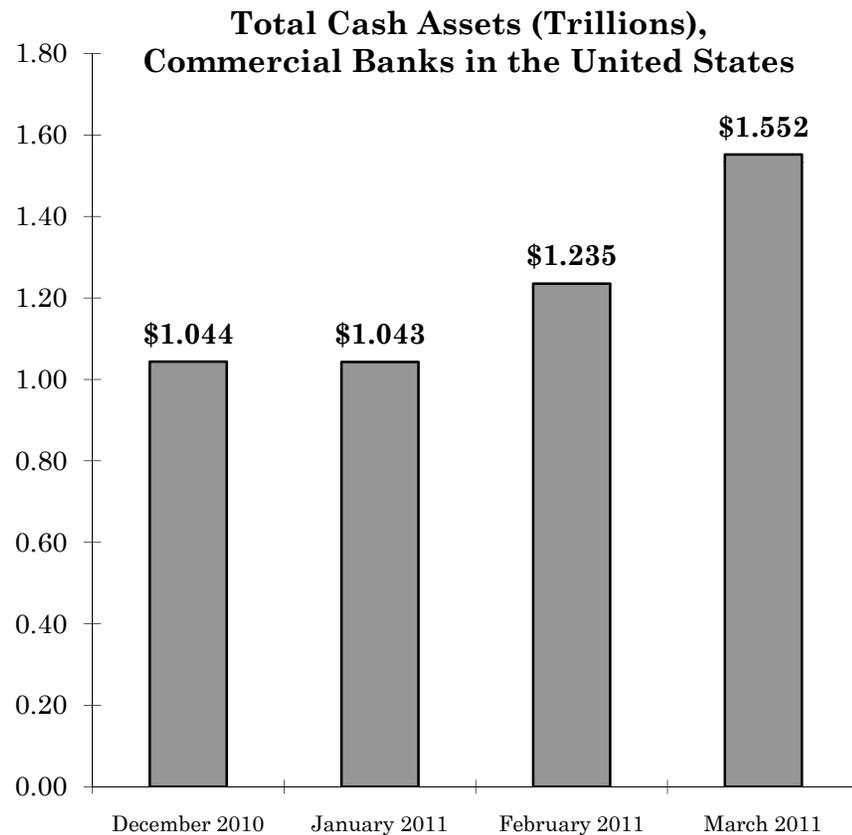
- ***Nationwide trends*** suggest that consumer access to credit is driving broader economic developments—but that credit scores are lagging real economic activity and are a potential source of abuse.
- ***State and local variations*** in consumer and market conditions make federal regulation of credit scores difficult—and expose state officials to unique risks of consumer harm.
- ***Federal regulation*** in this area is in its early stages, and Dodd-Frank leaves significant gaps for regulators to fill.
- ***State-level evidence*** will be critical to protecting consumers from credit-score abuses.

Nationwide Trends

Over the last four months, commercial banks have built large cash reserves while consumer lending has been stagnant.

While the largest banks have increased their cash holdings

. . . . Lending to consumers has been relatively stagnant.



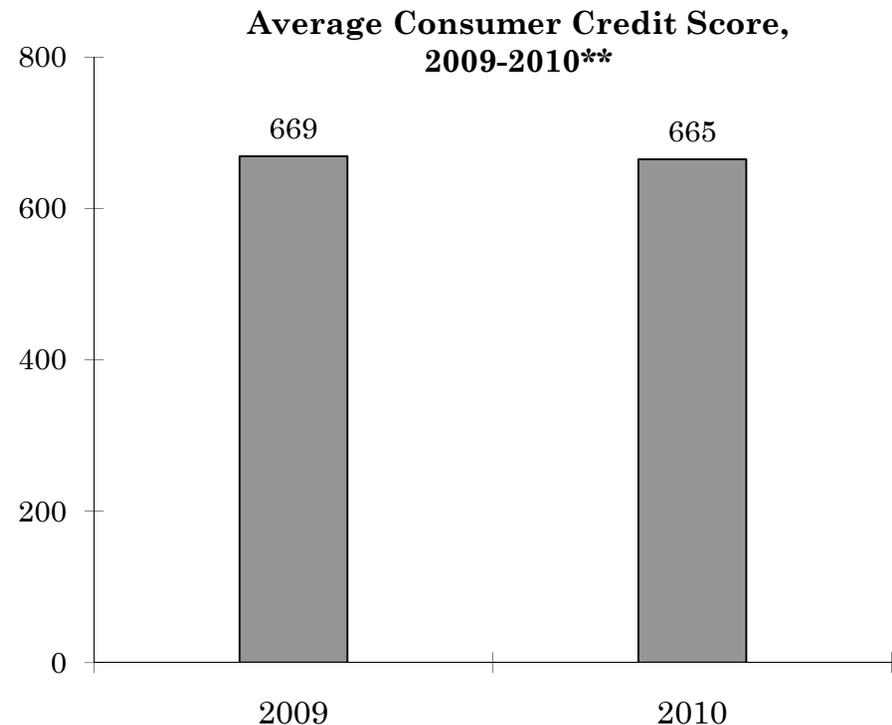
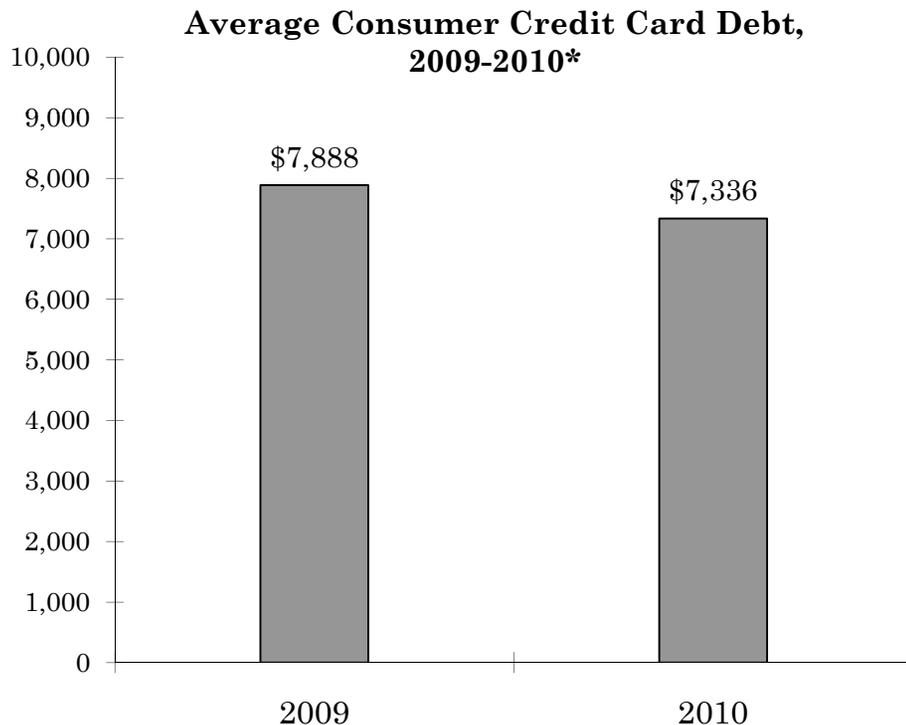
Source: Board of Governors of the Federal Reserve System, *Assets and Liabilities of Commercial Banks of the United States* (H8).

Nationwide Trends

In the meantime, as Americans have paid down their credit card debt, their consumer credit scores have *declined* slightly.

Although Americans have increasingly repaid credit card debt

. . . . Improvement in their credit scores has not immediately followed.



Source: *United States Credit Score Climate Report*, December 15, 2011. N=157,588.

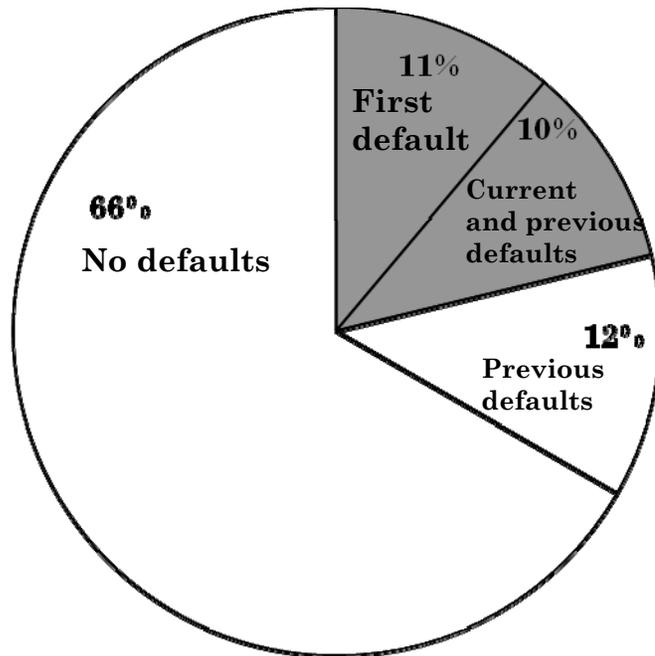
Nationwide Trends

One in five Americans experienced a negative credit event during the crisis. Whether—and when—they will get access to credit again is up to the three national credit-rating agencies.

For many, the crisis was their first experience with a negative credit event . . .

. . . . And their credit scores will be a key barrier to further access to credit.

Consumer Default Profiles
During the Financial Crisis



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- According to the credit bureaus, it will take **three years** for a consumer's credit score to recover from being 30 days late on one mortgage payment.
- It will take **seven years** for a consumer's score to recover from a foreclosure.

Source: Deloitte, *The Next Chapter in Consumer Lending: A New Way Forward* (March 2011). N=5,142; *FICO Banking Analytics Blog, Research Looks at How Mortgage Delinquencies Affect Scores* (March 24, 2011).

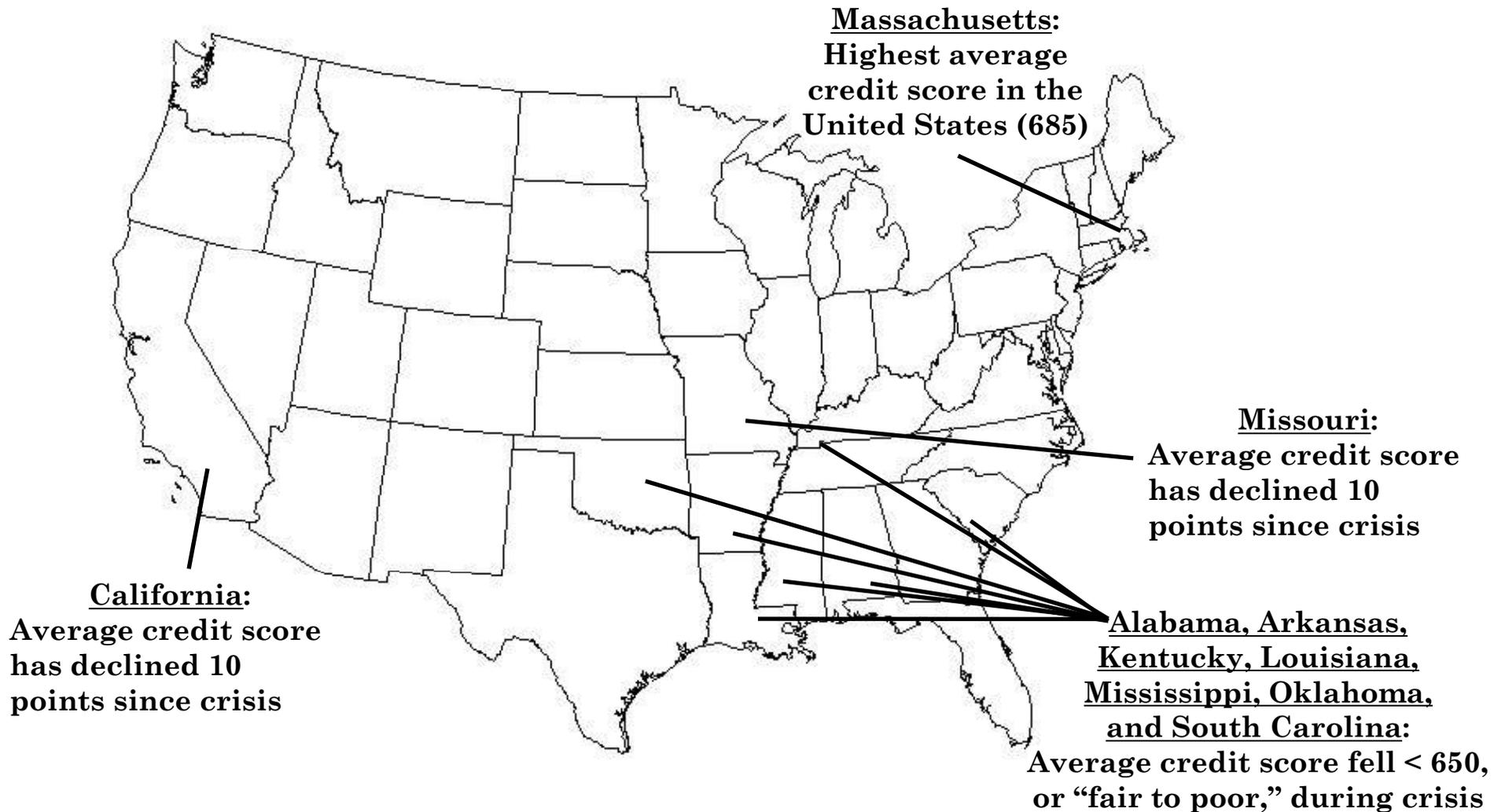
Potential for Abuse

Given their importance, consumer credit scores, and the bureaus that produce them, raise significant consumer-protection issues.

- Anecdotal reports suggest that credit reports allowed *predatory lenders to target low-quality borrowers* before the crisis.
- While estimates vary, several reports claim that *frequent errors in credit reports lead to inaccurate credit denials*, particularly for low-income consumers.
- Credit-card issuers have been accused of using *transaction-specific details to reduce credit lines*; in a Congressionally mandated report last year, the Federal Reserve argued that these practices are rare.
- *“Credit repair” firms prey on consumers facing low credit scores*; although these firms are technically subject to the Credit Repair Organizations Act of 1996, enforcement is limited.

State and Local Effects

The impact of credit scores on consumers varies significantly on a state-by-state basis.



Source: *United States Credit Score Climate Report*, December 15, 2011. N=157,588; sample size varies by state.

Federal Regulation

Previous federal statutes, as well as Dodd-Frank, provide for some regulation of credit bureaus and their work—but, as the CFPB appears to acknowledge, substantial gaps remain.

- The *Fair Credit Reporting Act* requires disclosure to consumers of negative credit events and provides for a dispute procedure.
 - In January 2011, the Federal Reserve and FTC finalized rules requiring disclosure to consumers of “risk-based pricing”: when their credit score is the basis for unfavorable credit terms.
- Section 1100F of *the Dodd-Frank Act* requires disclosure by *users* of credit scores of the factors that adversely affected a credit decision.
- Last year the Federal Reserve recently issued an online “Guide to Consumers” on the use of credit reports and credit scores.
- The Consumer Financial Protection Bureau, however, has expressed interest in the need for further rules in this area.

State-Level Evidence

State officials are uniquely positioned to get ahead of consumer protection abuses related to credit scores—and to provide the CFPB with invaluable data for federal efforts.

- Federal regulators have *no formal access to state-level detail on credit scores and their effects on consumer credit*, but these data are necessary to protect consumers.
- Through enforcement efforts designed to protect consumers from abuses related to credit scoring—and particularly the use of erroneous data from crisis-era credit events to deny consumers credit in the future—*state officials are in a position to provide this evidence to federal regulators*, such as the CFPB.
- A coordinated effort *among state officials that produces nationally updated detail on this evidence* would be particularly valuable, both to the CFPB and the Federal Reserve.



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