Troubling Times Ahead For Credit Bureau Data Furnishers

By Jennifer Maisano CBSC

Over the past few years, Credit Score Disclosure notices have prompted consumer mortgage seekers to increase scrutiny of their credit bureaus. Today, however, thanks to the new FACTA 311 Risk Based Pricing notice requirements, the connection between higher, or less favorable, loan rates and credit bureau information has been brought to the attention of a much greater percentage of the nation's banking customers and credit union members.

Beginning in January 2011, requirements are in place for lenders to provide Risk Based Pricing notices to many consumers applying for new credit, as well as consumers that have been negatively impacted by changes in terms on their *existing* loans (such as increases in APR). Due to the complexity of both the Credit Score Proxy and Tiered Pricing methods for determining which consumers must receive the new notices, many lenders have opted to send the Risk Based Pricing notices to all consumers that apply for loans rather than trying to calculate which individual consumers have technically received "materially less favorable" terms as noted in Section 311 of FACTA.

As if the barrage of "FreeCreditScore.com" and other score monitoring commercials wasn't enough to bump up disputes volumes, lenders can expect the new notices to direct more and more consumers to obtaining and carefully examining their credit reports. Additionally, with almost 10% of the U.S. in job search mode, and thanks to the now widespread practice of employment screening credit bureau pulls, it is expected that dispute numbers will increase even more.

Impact of Recent FCRA and FACTA Court Decisions

Although the FTC has not recently penalized any single data furnisher with a significant FCRA or FACT Act related fine, FCRA experts within the FTC warn that "lenders should be more concerned with the consumer's right to private legal action with regards to FCRA and FACTA violations than regulatory fines." Specifically, legal actions related to technical violations of the regulations such as inaccurate reporting of consumer account information to the credit bureaus.

What makes litigation a bigger risk now than in the past? In a recent decision in *Bateman v. American Multi-Cinema, Inc*., the Ninth Circuit Court opened the door for more class actions seeking exorbitant amounts in statutory damages for technical violations of the FCRA and FACTA with its decision that an FCRA or FACTA class action could not be denied based on the enormity or disproportion between actual and statutory damages, and there was no evidence that lawmakers held the intent to preclude class actions under either of these regulations.

This means that the Ninth Circuit Court decided:

- That there was no intent by Congress to block civil litigation and class actions against data furnishers for violations of FCRA and FACTA, and
- *Bateman* was allowed to move forward ("certified") as a class action suit, and
- *Bateman* was allowed to move forward regardless of the enormous disproportion between the amount of actual damages sought (quantifiable damages) and statutory damages sought (not so easily quantifiable "harm") which, in this case was $29 million to $290 million.

While the issue in this case was AMC's violation of Section 113 of FACTA by printing full account numbers on receipts, the Ninth Circuit's decision was not specific to violations of only that one section of FCRA/FACTA. The *Bateman* decision, coupled with another decision in 2010 by the Seventh Circuit Court stating that the statutory damages provision of FCRA is "unconstitutionally vague and excessive," opens the floodgates for potentially enormous class action suits against data furnishers for <u>all types</u> of violations of FCRA and FACTA.

Common Credit Reporting Mistakes Most Data Furnishers Are Making Today

Both the Ninth and Seventh Circuits' recent decisions significantly increase risks for institutions that have not taken a hard look at all their FACTA requirements, but most significantly those intentionally or unintentionally overlooking Section 312's mandate for accuracy and integrity of credit reporting.

Many issues with credit reporting stem from the old adage "junk in… junk out." Incorrect set-up of account definitions, designations and codes during the implementation phase of a new core system or portfolio merger/acquisition related conversion accounts for an astonishingly large percentage of credit bureau reporting errors. And the biggest issue is that most data furnishers are unaware that their definitions are inaccurate.

For example, the most common error found during client audits is the assignment "Installment Loan" designation to accounts that are in actuality consumer "Mortgages." This may seem like an innocuous substitution, however, there are potentially substantial scoring consequences. A human manually reviewing a credit report may be able to compensate for such errors however, many scoring systems cannot as is depicted in the following case study derived from actual 2010 audits of four financial institutions:

> **Case Study - How Small Reporting Errors Can Impact Scoring**
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> In 4 recent audits, Banks North, West, East and South all had the same data processor. Their core system did not allow for designations of accounts as "mortgages," but instead coded these loans as "installment loans". As the length of mortgages should be reported in years rather than in months as required by installment accounts, in an attempt to compensate the core system also reported the lengths of these loans as "30" for 30 years.
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> **Issue:** Most scoring systems take data at face value with little or no interpretation. If you track the erroneous "Installment Loan" designation downstream, the credit scoring systems would see the following:
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> - An installment loan for an extremely large sum (i.e. $200,000).
> - Duration of payments for these loans was reported as 30, however, the number reported for an installment loan is seen by Metro 2® as 30 months, whereas, the number reported for a mortgage is seen by Metro 2® as 30 years.
>
> **Result:** Most credit scores would be calculated based on the facts reported -- "Installment" loan of $200,000 with what looks like payment term of 30 months. In effect, a 30 month payback period would require each payment be approximately $6600, whereas a 30 year payback period would yield a monthly payment in the vicinity of $1000. The perceived debt of $6600 per month could potentially negatively impact multiple factors of consumer lending such as approval scores, debt ratios, bankruptcy scores, pre-screen scores, etc.

And those types of errors are just the tip of the credit reporting iceberg. From a potential litigation standpoint, data furnishers that do not invest the time and resources required to evaluate the accuracy and integrity of their credit reporting *on an ongoing basis* are making a potential titanic mistake.

Taking Steps to Substantially Decrease Data Furnisher Risk

Data furnishers who believe they are reporting correctly because they receive few disputes are deluding themselves. In most cases minimal dispute volumes only mean that your consumers aren't yet educated enough to identify your errors. But consumer attorneys are quickly learning the technical ins and outs of the reporting process forcing data furnishers to overhaul their reporting strategies and reign in their entire data reporting programs.

"Reasonable procedures" not only include an extremely detailed field-by-field audit of the Metro 2® reporting file, but also include many other compliance procedures that are just as important. To stay protected, your FACTA 312 compliance program should, at a minimum, incorporate all of the following "reasonable procedures":

1. **<u>Annual Bureau Audits</u>** – Getting each bureau to provide you with an annual data audit. This process allows the bureau to give you a type of 'state of the union' evaluation of your data, telling you what they think may be wrong. However, bureaus will <u>not</u> identify root causes of errors or tell you how to fix them.

2. **<u>Annual Reporting Strategy Review</u>** – Evaluate your ongoing strategy to confirm core system definitions are accurate based on how each of the different account types and statuses should be reported.

3. **<u>Quarterly Internal Data Audit</u>** – Complete internal quarterly data audits to compare your core system account data to the values placed on the reporting file. The objective is to confirm that your account data is correctly coded when converting from your core system to the Metro 2® file. If errors are found, regulations mandate you **<u>find and fix root causes</u>** rather than manually correcting each error so that your institution does not continue to re-pollute consumer bureaus.

4. **<u>Quarterly Audit of Posted Data</u>** – Once you confirm your data is being placed on the reporting file in the correct form and format, you must also confirm that the information is displaying correctly on the consumer's bureaus. You will be surprised at how many times things are not displaying as you expect. *Note: Specific tools must be used to enable this process to be completed without posting hard inquiries to bureaus*.

5. **<u>Monthly Pre-Reporting Reality Checks</u>** – A quick "reality check" of your data should be completed before it goes out the door each month. Generally, this step encompasses reviewing key field volumes and codes to confirm data remains fairly consistent from month to month. While not a full audit, this quick check can alert you when something is seriously off.

6. **<u>Monthly File Delivery Confirmation</u>** – put a confirmation process in place to confirm that your data was received by each bureau. This is especially important if you have not yet implemented electronic data delivery and are still mailing hard media.

7. **<u>Daily Queue Review</u>** – check your e-Oscar queues daily to make sure you are staying within the FCRA mandated 30 day response date for disputes.

Consumer attorneys are just waiting to take a nice juicy bite out of your institution. Implementing and maintaining a full-fledged FACTA 312 compliance program will actually help keep you ahead of the litigation trend. But expertise doesn't grow overnight. If you need help, get it *before* you regret it!

CBSC
Credit Bureau Strategy Consulting, LLC
Building Your Business On Data Integrity

Jennifer Maisano is the President and CEO of Credit Bureau Strategy Consulting, LLC. CBSC provides superior and comprehensive consulting services focusing on assisting data furnishers in developing and implementing FACTA 312 compliance programs. CBSC's specialty is providing expert data audits. CBSC also offers do-it-yourself FACTA 312 compliance products and training. For more information contact Jen at 410-208-6797, **<u>Jen@CBStrategyConsult.com</u>** or visit **<u>www.CBStrategyConsult.com</u>**