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January 4, 2004

Federal Trade Commission/Office of the Secretary
Room H-159
600 Pennsylvania Avenue, NW
Washington, DC 20580

Re: FACTA Credit Score Fee, Project No. R411004

To Whom It May Concern:

This comment letter is submitted to the Federal Trade Commission (FTC) on behalf of the Information Policy Institute in response to the Advanced Notice of Proposed Rulemaking published in the *Federal Register* on November 8, 2004 regarding fees for credit scores. The Information Policy Institute, a non-profit, non-partisan research organization, is the nation's only think tank dedicated primarily to the study of the regulation of information. The Institute has testified before Congress and the FTC on matters pertaining to the regulation of consumer credit reports, and is grateful for an opportunity to comment on this matter.

The Fair and Accurate Credit Transactions Act of 2003, Pub. L. 108-159, 117 Stat. 1952, amends the FCRA to add a new subsection 609(f) to the FCRA, giving consumers the right to obtain disclosures of credit scores and related information. Subsection 609(f)(8) provides that the consumer reporting agency may charge a "fair and reasonable fee, as determined by the Commission" for such disclosure. The following comments pertain to the question of how the Commission might determine what constitutes a "fair and reasonable fee."

Before considering the question of how one might determine what constitutes a "fair and reasonable fee", another question must be resolved: what justifies government intervention in the market and do these conditions obtain in this instance?

The most prominent instance of government intervention in pricing and supply is utilities. These services were considered essential to the welfare of citizens and firms that provided them were seen as public service enterprises. A firm is classified as a public service enterprise if there is no readily available substitute, and if it provides a good or service essential to the functional existence of an individual in contemporary society. Furthermore, if there are substantial barriers to entry, incumbents can extract rents and undersupply services, monopolizing the sector. Given that these services typically favored monopoly providers, and as these services were essential to the welfare of citizens, it was necessary to ensure that providers did not gouge or undersupply consumers. Thus a public service enterprise or public utility designation normally carried

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with it obligations that service be provided without discrimination and be made available at a fair and reasonable rate to all those who needed it.

This has been the principal justification for public control over pricing. Even in debates such as price control for pharmaceuticals, the monopolistic nature of a specific drug's supply and the fact that it is necessary for consumer well-being are presented as the justification for public intervention. The issues at hand are: (i) whether a credit score is a monopolized or oligopolized good stemming from the absence of substitutes and high barriers to entry, *and* (ii) whether it is essential for consumers. And following that discussion, we turn to the question of how the FTC should determine a "fair and reasonable" rate for credit score disclosures.

Does Sufficient Competition Exist in the Market for Credit Scores, that is, is it monopolized or oligopolized?

There are three national consumer credit reporting agencies, in additional to several local and regional specialty boutiques. The 2002 Census of Manufactures lists 914 establishments that have receipts from furnishing credit reports on consumers.[1] These entities qualify as "consumer reporting agencies", and therefore would fall under the scope of the proposed rule. However many of the entities offering score products would not be bound by such a law. For example, most large financial institutions have custom scoring products, not to mention the many information services firms that specialize in these types of analytical techniques. It is reasonable to infer from the sheer number of firms in this market that any barriers to entry are insignificant, and that a reasonable degree of competition obtains

The barriers to entry in developing models and scoring are low. Currently, a large number of financial institutions use credit report information to develop their own decisioning models. Then, there is no single score to speak of, but rather thousands of scores offered by dozens of players, as well as internal scores for hundreds of financial firms. Clearly many of the scores based on credit data are not available to consumers for purchase. The scores that are offered to consumers are generally a variant of the ubiquitous FICO score and very useful to consumers as they explain their creditworthiness by aggregating hundreds of data points into a single dimension.

The presence of so many scoring models in the market speaks to ease of entry. The costs of anonymized credit files (those stripped of identifying information), expertise, and computing technology—the inputs to develop a scoring model--are relatively low. The

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[1] US Census Bureau, *2002 Economic Census: Administrative and Supportive and Waste Management and Remediation Services.* (Washington, DC: Department of Commerce, July 2004) p. 6, http://www.census.gov/prod/ec02/ec0256i04.pdf.

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sector in fact witnesses fierce competition—in the form of constant innovation in scoring models—and ever new entrants into new segments. The ubiquitous FICO score is calculated and sold by all 3 CRAs, as well as by others, including Fair Isaac Corporation. And many substitutes for this model exist.

Further evidence of the degree of competition can be found by analyzing the price range at which consumer credit scores are offered. Typically, consumer credit scores are not sold as "stand alone" products, but rather are bundled with the underlying consumer credit report from which the credit score was derived. As the FTC has noted, credit scores are readily available from a host of providers for a modest fee ranging between $4 and $8. While this band may seem rather large at first blush—100% increase from the lowest to the highest bound—the three national CRAs offer scores as a complementary good to a credit report for an additional fee of approximately $6. In all likelihood, the width of the price band reflects attempts by some sellers to capitalize on either brand or cost advantages and is consistent with pricing strategies in a competitive market.

Are scores essential for consumers?

There is little question that credit information and credit score play a crucial role in determining consumer welfare. But some aspects of how they do so should be kept in mind. First, scores generally play a crucial role in determining consumer welfare, but no specific scoring model does so. While the Classic FICO score is the most common one found in the marketplace, the model can, and in the future, most likely will be supplanted by scores that better rank the odds of default. Furthermore, many other models are commonly used.

Secondly and more importantly, while scores do play a crucial role in determining consumer welfare, it is not by virtue of their use by consumers. Rather, it is the use of credit scores by credit providers that is crucial for consumer welfare. Consumers instead require reports to assess whether information on reports is inaccurate and to see the content of their reports in the event of a negative decision. The score itself is meaningless to consumers, save as a ranking of their riskiness. (This point, of course, ignores the fact that there are a myriad of scores that vary by models, which themselves vary by company and credit instrument.) The FACT Act already provides for free reports in the event of a negative decision, as well as for a free report annually. Finally, consumers can easily make use of ubiquitous promotional offers that provide scores, along with explanatory materials, for free. These are largely part of marketing efforts to sell a broader array of services, but they are provided for free without any requirement to purchase the services.

It should be noted that none of the proponents of price controls for credit scores for consumers have made the case that the consumption of a credit score *by the consumer* is an essential for the consumer's welfare. And there is no argument that it is essential. On

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this ground, the proposal fails to meet an essential criterion for price control.

Different Approaches to Setting a "Fair and Reasonable Fee"

In the Commission's request for comment (Docket Id: RIN 3084—AA94), they consider a number of possible approaches for how the Commission might determine of what would be a "fair and reasonable fee" for a credit score disclosure. We consider each of these possible approaches in turn below.

1) Fixed Price Approach

"One approach might be to establish a single mandatory price that regulated entities must charge for a score disclosure."

As the Commission aptly notes, there are several caveats associated with a mandatory single price:

- A fixed price may be higher than what a consumer might pay in an unregulated market;
- A fixed price set too low may dilute the quality of the product offered;
- And, a fixed price will place regulated entities at a disadvantage to non-CRA sellers of credit scores.

Beyond the concerns outlined by the FTC, such price regulation could become *de facto* regulation on entities beyond the FCRA's reach. In the event of a low fixed price, non-CRA sellers of credit information may be forced to lower their prices in order to remain competitive with CRA sellers of credit scores. And this may dilute the quality of market offerings even where the sellers are not regulated as they are forced to cut the costs associated with score products.

2) Fee Cap Approach

Setting a maximum price would be analogous to the manner in which the FCRA currently caps the cost of a credit report disclosure. And such an approach would give regulated entities the ability to still compete on price. But again, as the FTC notes, this approach has its drawbacks:

- If the price cap is set too low, it may dilute the quality of the product offered;
- If the price cap is set too low, regulated entities will be placed at a disadvantage to non-CRA sellers of credit scores;
- A maximum price may become a *de facto* mandatory price—this is in fact what has occurred in the market for credit report disclosures. It is what has happened in many utility markets.

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And as in the case of a fixed price approach, it is likely that unregulated entities will have to reduce the price of credit scores to match those of their regulated competitors.

Another issue common to both the "fixed price" and "fee cap" approach to regulation is the issue of how to index the score to reflect the changing costs of input costs. For example, the cap on credit report disclosures is indexed to the Consumer Price Index. One obvious disadvantage to such an approach is that industry specific changes may not be adequately represented by CPI.

3) Market Based Pricing

In a competitive environment, a market based price sets a "fair and reasonable" standard. As long as competitive forces, such as relatively low barriers to entry, continue to obtain, market prices will be "fair and reasonable" as those firms which do not adjust prices to competitive levels will be driven out of the market or forced to adjust prices. Price regulation that somehow dynamically reflects the market (i.e. a function of the weighted average of market prices) still raises a number of significant concerns:

- Price regulation may compel regulated entities alter prices that they would otherwise charge;
- Price regulations could *de facto* apply to unregulated sellers of credit scores;
- Price regulations could thereby distort the underlying market upon which calculations of any price controls are based, creating a feedback loop amplifying market distortion;
- And, price regulations could be calculated in such a fashion that they have no effect on the market altogether, thereby negating the rationale for regulation altogether.

Even should the Commission proceed with a market based approach to setting a "fair and reasonable" price for credit score disclosures, it must be careful not to rely too heavily on the current price band to justify intervention. For instance, it is theoretically possible that one or more of the CRAs could offer a score disclosure for more than $8, and that the price would reflect the application of a significant new innovation (e.g. a new, and more accurate scoring algorithm) or that is bundled with valuable add-ons (e.g. consumer educational material). In such cases, should the Commission mandate a price reduction, would be acting in such a way as to distort the market in ways that would be harmful to continued competition. Such a scenario would hinder innovation.

Conclusion

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The costs of scores rest almost entirely with the development of the models themselves. Of course, once the models are developed, the marginal costs of providing a score are small, but initial costs, as well as the costs of regularly developing better scoring models, must be recouped. The imposition of effective price controls would have serious risks. First, the industry as a whole would have to drive prices down to the maximum allowed by regulation and imposed on consumer reporting agencies in order to compete along price dimensions. The industry as a whole would see a loss of revenue that could be allocated for the development of new and better scoring models, as well as for experiments such as non-traditional scoring models for the underserved. This would hamper the ability of regulated entities to innovate and develop new scoring models, and they would be left disadvantaged in the market. Again, innovative products would be undersupplied, and consumers would suffer.

We strongly recommend that the FTC come to the conclusion that the market is already providing consumers the opportunity to purchase credit scores at a "fair and reasonable" price. Thank you for providing us the opportunity to comment upon this matter.

Sincerely,

Michael A. Turner, Ph.D.

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Information Policy Institute