PREPARED STATEMENT OF

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On

"Examining the Need for H.R. 2885, The Credit Monitoring Clarification Act"

Before the

HOUSE COMMITTEE ON FINANCIAL SERVICES

Washington, D.C.
May 20, 2008

Chairman Frank, Ranking Member Bachus, and members of the Committee, thank you for inviting me to testify today on the need for H.R. 2885, the Credit Monitoring Clarification Act. My name is Howard Beales, and I am an Associate Professor of Strategic Management and Public Policy in the Business School at George Washington University. I have a Ph.D. in economics from the University of Chicago, and more than a decade of experience addressing consumer protection issues at the Federal Trade Commission. Most recently, I was Director of the Bureau of Consumer Protection from 2001 through 2004. I am appearing today on my own behalf, as a former official who had responsibility for enforcing the Credit Repair Organizations Act (CROA), and an academic with a long-standing interest in consumer protection regulation.

Let me begin by describing the problem of credit repair, and the approach CROA takes to address the problem. Then I will turn to more recently developed services that are arguably swept under CROA, though they are very different from the credit repair services that were the target of CROA.

The crucial characteristic of credit repair is its promise to remove or change accurate information in the consumer's credit file. By its very nature, this promise is inherently fraudulent. Accurate, timely, negative information bearing on creditworthiness cannot be removed by the consumer, or anyone else acting on the consumer's behalf. Indeed, creditors' ability to obtain accurate information that the consumer might prefer not to share is crucial to the integrity of the consumer credit system, and makes possible the miracle of instant credit.

Although there is no legitimate way to remove accurate information from credit reports, credit repair organizations attempt to exploit the system to get accurate information removed. For example, some credit repair organizations have advised consumers to apply for an employer identification number and use that instead of a Social Security number when applying for credit. Others have repeatedly disputed the same accurate information, in the hopes that the furnisher who provided the information will fail to respond to the dispute in a timely fashion and the credit reporting agency will have no choice but to remove the information from the credit report, at least temporarily.

At least conceptually, there is nothing wrong with paying someone else to go through the process of correcting inaccurate information in a credit report. Thus, at a conceptual level, it is possible to imagine a legitimate credit repair service. If they exist at all, however, such services are exceedingly rare.

Rather than prohibit credit repair outright, Congress imposed a business model that is simply not workable for a mass market consumer product or service, particularly one that is arranged and often delivered online. No credit repair organization may charge for its service before the service is fully performed. Although consumers pay for many personal services after the service is performed, payment after the fact is largely confined to services where there is a face to face relationship between the buyer and seller, or where there is an ongoing relationship between them. I am not aware of any mass market, relatively standardized service that is sold on such a basis. It is simply not a feasible way to conduct most consumer transactions. In addition, there must be a written contract, which is virtually nonexistent in the personal services that are actually paid for after the service is performed, a three day cooling off period before the contract becomes enforceable, and extensive disclosures. Imagine what it would like to get your lawn mowed if sellers followed that business model.

Given the difficulties of the CROA business model, it is perhaps not surprising that there appear to be relatively few cases in which organizations admit that they are credit repair organizations subject to CROA. Instead, they try to structure their operations to avoid the statute. They attempt to distinguish credit counseling services from credit repair, or they offer to renegotiate overdue debts with creditors, or they structure themselves as "nonprofit" organizations. And if they are credit repair organizations, they structure their fees as numerous smaller fees for specific tasks such as setting up a file to skirt the prohibition on accepting payment before the service is performed.

Imposing an unworkable business model on a business that is almost always fraudulent is not particularly problematic if the definition is tightly drawn. CROA's definition, however, is extremely expansive, in part because there were virtually no legitimate businesses that fell within the definition when the statute was enacted.

The critical language in CROA is the definition of a credit repair organization, and is extremely broad. It includes "any person" who uses interstate commerce "to sell, provide, or perform" any service, or represent that they will do so, "for the express or implied purpose of (i) improving any consumer's credit record, credit history, or credit rating; or (ii) providing advice or assistance to any consumer" about those subjects.[1]

Read literally, this language would cover some of the Federal Trade Commission's consumer education materials, like "Building a Better Credit Report," which will let you "learn how to improve your credit score, deal with debt, spot credit-related scams, and more." [2] The FTC makes these materials available for free, but they are also available through the Federal Citizen Information Center in Pueblo, Colorado, for a charge of $1 – before any advice is given.[3] For only $1 more you can pick up a copy of "Your Credit Scores," cosponsored by the Consumer Federation of America, and learn "how to raise your score" -- also payable before the advice is rendered, and well before the score is actually raised. Whether you order one pamphlet or both, there is no written contract, no cooling off period, and no disclosure document, all of which CROA require.

It is absurd to think that Congress meant to restrict such obviously valuable consumer education efforts as these when it enacted CROA. But to avoid the conclusion that they are in fact covered, you have to be willing to look beyond the seemingly plain statutory language. There is, after all, a sale, of advice, about improving your credit rating. The

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[1] 15 U.S.C 1679a(3)(A).

[2] The marketing description is taken from the Federal Citizen Information Center's website, at http://www.pueblo.gsa.gov/results.tpl?id1=18&startat=1&--woSECTIONSdatarq=18&--SECTIONSword=ww (visited May 17,2008).

[3] In the interest of full disclosure, there is also a $2 "service fee" for any order, which is waived for free publications ordered online.

price is low, but the statute bans a CRO from receiving *any* money before the service is "fully performed." On the plain language of the statute, the only interesting question is whether the credit reporting organization is the Federal Citizen Information Center, the Federal Trade Commission, or the Consumer Federation of America – or perhaps all three are covered. If any or all of them are credit repair organizations, there is no practical way to make this information available through the Federal Citizen Information Center.

Unfortunately, there are valuable real world, commercial products currently on the market that face exactly this dilemma. One such service is credit monitoring. The typical credit monitoring service alerts consumers to any change in their credit reports, at either one or all three of the major consumer reporting agencies. A principal value of such services is their ability to alert consumers that they may be the victims of identity theft. The FTC has stated that "as a matter of policy, the Commission sees little basis on which to subject the sale of legitimate credit monitoring and similar educational products and services to CROA's specific prohibitions and requirements…"[4] The products have seemed valuable enough that federal government agencies have offered them for free to consumers whose information has been compromised in data security breaches.[5] The whole point of these services is to detect identity theft as early as possible, to enable consumers to improve "their credit record, credit history, or credit rating" by correcting information that was only included because of fraud. Like the consumer education examples, there is a payment before services are delivered, there is no written contract, there is no cooling off period, and there is no disclosure document. And like consumer education, there is no conceivable public purpose in restricting these services.

Another example is services that evaluate what consumers might do to improve their credit scores. Credit scores are vital to the availability of credit to some consumers, and they influence the terms of both credit and insurance for the vast majority of consumers. It is important for consumers in the modern world to understand what influences their credit score, and what they can do to improve it. That is, consumers need "advice" about how to "improve" their "credit rating."

Of course, consumers cannot improve their credit score by changing the past, which is the essence of what the traditional credit repair organization promises to do. But consumers can change their credit rating by changing their behavior. Some changes, like consistently paying on time, may take a significant amount of time before they change a credit score. Other changes, like paying down outstanding debt, or even redistributing debt across different credit accounts, can affect credit scores more quickly. Unfortunately, there are also "urban myths" about how to improve credit scores – like

[4] Prepared Statement of the Federal Trade Commission Before the Senate Committee on Commerce, Science and Transportation, United States Senate, July 31, 2007, at 19 (available at http://www.ftc.gov/os/testimony/P034412telemarket.pdf) (Visited May 17, 2008).

[5] See, e.g., USDA Offers Free Credit Monitoring to Farm Services Agency and Rural Development Funding Recipients Q & A, available at http://www.usa.gov/usdaexposure.shtml#Receiving%20a%20Letter (Visited May 17, 2008).

closing unused accounts – that will likely reduce credit scores if consumers follow that (usually free) advice. Consumers, particularly those with lower credit scores, need accurate information about how they can best improve their credit score. They need, in the language of CROA, "advice."

Many, including government agencies, can offer general advice about how to improve credit scores for free. But the nature of credit scoring is that the most important factor reducing the score for one consumer may *not* be the most important factor for another, with a different credit history and different circumstances. The most valuable advice is personalized advice, which requires access to the consumer's credit report. That, in turn, involves an up-front cost, which reasonably requires an up-front payment. If such personalized advice services are covered by CROA, that up-front payment is illegal. Again, it serves no conceivable public purpose to prohibit these services.

It is possible to avoid the absurd result that CROA effectively prohibits up front charges for consumer education materials, credit monitoring, or personalized advice about the factors most likely to improve a particular consumer's credit score. Doing so, however, requires looking beyond the simple, and expansive, language of the statute, which would apparently sweep in all of these services.

Some courts have been willing to do so; others have not. Perhaps not surprisingly, willingness to look for the underlying Congressional purpose has seemed to depend on the particular facts of the case – and especially, on whether it appeared to be a truly legitimate service. Unfortunately, as is often true, bad facts make bad law – and some of the cases have involved some very bad facts.

Let me start with a case that involved good facts – Hillis v. Equifax Consumer Servies and Fair Issac Inc.[6] The case involved "Score Power," which was provided in a joint venture of Equifax and Fair Issac. It included an Equifax credit report, a FICO score based on that report, and access to a simulator that allowed consumers to see how various actions might affect their scores over time. It was, in essence, the personalized advice about how a consumer might improve his or her credit score discussed above.

In Georgia, the District court judge in Hillis was willing to look beyond the statutory language of CROA to consider what Congress was trying to accomplish. It concluded that

> … the Court is persuaded that the terms in the definition of a CRO (credit record, credit history, and credit rating) all refer to component of a consumer's historical, tangible, and displayable credit record. In short, Congress defined a CRO in a way that focuses not on 'credit' generally, but instead on those who claim they can undo or improve a consumer's past, historical, displayable, and tangible credit record.[7]

[6] Hillis v. Equifax Consumer Services, Inc. and Fair Issac, Inc, 237 F.R.D. 491 (N.D. Ga); 2006 U.S.Dist.Lexis 60182 (August 18, 2006, N. Dist. Ga.).
[7] Id. at 516.

The court did not grant summary judgment, however, because it believed "there is at least a genuine issue of material fact as to whether Defendants, through their representations, implied to the average consumer that they performed a form of credit repair or instead were merely engaged in a form of legitimate credit counseling to help consumers improve their FICO scores over time."[8]

The line drawn in Hillis is a reasonable one. Unfortunately, other cases have not turned out the same way, even with good facts. In Helms v. Consumerinfo.com, decided before Hillis, the district court judge in Alabama considered a pure credit monitoring service. She found "it doubtful that Congress intended the definition of credit repair organizations to be construed so narrowly so as to cover only fraudulent companies."[9] Perhaps misled by the statute's approach, she also noted that "CROA is not a blanket prohibition on the operation of credit repair businesses."[10] It is, however, a practical prohibition, and for a business interested in offering a useful service to consumers, the difference between blanket and practical prohibitions is immaterial. Attempting to structure a product to avoid CROA's coverage, if possible at all, would likely involve considerable legal risk.

Other cases have involved bad facts, at least according to the complaints. Zimmerman v. Cambridge Credit Counseling Corp. et. al.,[11] for example, involved a company that was organized as a not for profit organization, representing that it would help consumers reduce their debt payments and thereby improve their credit ratings. The court held that CROA applied, dismissing the Hillis decision in a footnote that stated "it would betray the statute's intent to confine CROA's reach to only those practices that Congress explicitly identified in enacting it."[12] It is worth noting that in the Ameridebt case[13], the FTC pursued very similar allegations without invoking CROA.

To avoid losing valuable services for consumers, a line must be drawn to distinguish legitimate credit monitoring from illegitimate credit repair. The line drawn in Hillis is a reasonable one, if the courts follow it. It is, however, a line, and it creates the need to prove that a credit repair fraud that seeks to disguise itself as a credit counselor or a credit monitoring service is in fact making claims to consumers that it can modify their historical credit record. If the courts instead follow Zimmerman, valuable services will likely be prohibited.

Congress, rather than the courts, should draw the line. Courts have been attempting to discern exactly how Congress intended the broad language of CROA to apply, and they have come to different conclusions. Congress should clarify the statute.

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[8] Id. at 517.
[9] Helms v. Consumerinfo.com, Inc., 436 F. Supp. 2d 1220; 2005 U.S. Dist. LEXIS 42777 (Feb. 14, 2005, N. Dist. Ala.).
[10] Id. at 1234.
[11] Zimmerman v. Cambridge Credit Counseling Corp., 529 F. Supp. 254. 275; 2008 U.S. Dist. LEXIS 3155 (Jan. 7, 2008, Mass.).
[12] Id. at n. 20.
[13] FTC v. Ameridebt et al., filed November 19, 2003, available at http://www.ftc.gov/os/caselist/0223171/031119compameridebt.pdf (Visited May 19, 2008).

Whether drawn by Congress or the courts, any line that distinguishes between fraudulent and legitimate will create new opportunities for the credit repair organizations that are the real target to seek to avoid the statute. That is inherent in distinguishing between fraudulent and legitimate conduct, and it is not without costs. There are obvious advantages to private plaintiffs and public enforcement agencies in needing only to prove that advice about credit was promised, without worrying about whether it was legitimate advice or fraudulent. But the alternative to drawing a line is to prohibit legitimate services that are valuable to consumers, and that involves even higher costs. It is Congress, not the courts, that should seek to strike the best possible balance.