

FICO 08 AND OTHER DEVELOPMENTS IN THE CREDIT SCORING INDUSTRY

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1. Trouble Brewing

The Fair Isaac Corporation developed the FICO score to give credit issuers an analytical tool to determine a borrower's likelihood of default. Since its development,¹ the FICO score product has become the standard consumer credit score used by creditors to make more informed lending decisions. However, as the consumer finance market has evolved in recent years, the FICO score's predictive power has suffered. According to a 2001 Fitch study,² the FICO scores of borrowers who stopped making home-loan payments differed on average by just 31 points from those paying on time. By 2006, this gap had shrunk to only 10 points. At the same time that its predictive power for evaluating borrowers is declining, FICO scores are being used in an ever-growing multitude of applications that seem far removed from the function these scores were designed to serve. For example, credit reports are not only used to prescreen credit card offers, but also to set insurance premiums, and to evaluate prospective candidates for jobs. According to BusinessWeek magazine, retailers even use FICO scores when deciding on where to place new locations for their stores.³

Compounding the problems arising from the use of credit scores in these new applications, some entrepreneurial businesses have discovered techniques to manipulate FICO scores based on loopholes in the FICO formula. In fact, an entire cottage-industry has developed, consisting of companies offering to boost consumers' credit scores through a technique known as "credit piggybacking."⁴ The Fair Isaac Corporation has routinely redeveloped its formula since the initial release of FICO in 1989; however, under pressure from its customers (creditors) due to the worsening problem of score manipulation, it has recently released an upgrade for its credit scoring formula: FICO 08.

¹ History, <http://www.fairisaac.com/fic/en/company/history.htm>

² Foust, D. and Pressman, A. "Credit Scores: Not-So-Magic Numbers," Feb. 2008, http://www.businessweek.com/print/magazine/content/08_07/b4071038384407.htm

³ Id.

⁴ BoostMyScore.net - Your Credit Advisor - Home Page, <http://boostmyscore.net/>

2. BoostMyScore.net and Other Credit-Boosting Companies

Although the detailed mechanics of the FICO algorithm are not known outside of the Fair Isaac Corporation, a few flaws have been observed by the public, leading to the development of the credit boosting industry, which targets consumers with poor or non-existent credit histories. One such company, BoostMyScore.net was founded in 2007.⁵ The company could be termed an innovator in the “credit piggybacking” industry, providing what is essentially a matching service that connects people with a strong credit history, called “credit-lenders” to customers with poor credit scores, who are willing to pay a price to boost their scores. The key to the piggybacking business is how authorized user accounts are incorporated into the FICO score calculation. From BoostMyScore.net’s website:

CREDIT PIGGYBACKING

“‘Credit Piggybacking’ is when one person is listed as an authorized user on someone else’s credit card, someone with a healthy credit rating. The authorized user does not typically use the card, but the credit history of that card appears on their credit report. When the new history appears in the authorized user’s credit reports, their credit score is immediately recalculated to show an increase as a result of the new card’s presence in the report. While the authorized user does not receive the physical card or account number, they do receive the benefit of having that particular credit card’s entire credit history - limit, balance, payments - in essence “copied and pasted” onto their credit report, looking as though it were there the entire time. Having a higher FICO (c) Credit score means lower interest rates, easier loan approvals, higher credit limits and better terms for consumers.”⁶

The company’s founder, Bill Airy explained that he discovered the piggybacking effect by accident while applying for an auto loan with his wife.⁷ At the time his wife, a South African citizen, had only recently received a social security number, so they were considering whether including her name in the credit application would raise the cost of their loan. The dealership ran a credit check, and they were surprised to learn that she had a credit score of 785—a score better than his own.⁸ Previously, he had added her as an authorized user on his credit cards, and due to what seems to be a logical flaw in the FICO algorithm, she received the benefit of

⁵ BoostMyScore.net - Your Credit Advisor - About Us, <http://boostmyscore.net/about.html>

⁶ Id.

⁷ Interview with Bill Airy (April 2009).

⁸ Id.

the full payment history associated with that credit card account, giving her a rating that classified her within the top 40% of the US population, despite having no personal credit history.⁹

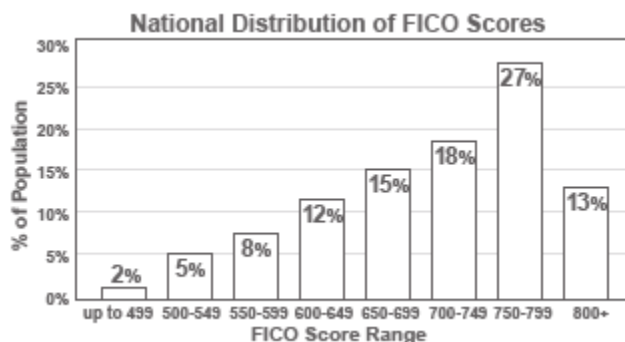


Figure 1 National distribution of FICO scores¹⁰

From this experience, Mr. Airy realized the significant impact this technique could have on consumers with poor credit scores, and how valuable a service based on this effect could be. On its website, BoostMyScore.net clearly identifies the value proposition for consumers: a higher FICO score will lower the interest rate on a loan, saving thousands of dollars in interest expense each year for consumers planning a large purchase, such as a house.¹¹ For some consumers, using a quick fix method to boost their FICO score seems like a winning proposition, even at the cost of several hundred, or thousands of dollars in upfront charges.

According to Instantcreditbuilders.com, “one borrowed credit card account can increase a score between 30 and 45 points, two between 60 and 90 points, and five between 150 and 205 points.”¹² Although others in the industry dispute the precision of these estimates, given the FICO score’s range of between 300 and 850, and the score distribution in the figure above, this effect can be substantial.¹³

⁹ Id.

¹⁰ Liz Pulliam Weston, What Is a Good Score, Your Credit Score, Your Money & What's at Stake (Updated Edition): How to Improve the 3-Digit Number That Shapes Your Financial Future, “How Credit Scoring Works,” 2009.

¹¹ BoostMyScore.net - Your Credit Advisor - Secret, <http://boostmyscore.net/secret.html>

¹² “Credit Card 'Piggybacking' Worries Lending Industry,” June 2007, <http://www.foxnews.com/story/0,2933,277874,00.html>

¹³ Bill Airy of BoostMyScore.net contests the numbers offered by ICM as an overgeneralization, arguing that the boost for an individual consumer will have far more variation, depending on what is initially in their credit report. According to Airy, the size of the boost depends on 1) the number of tradelines added; 2) the number of credit cards currently in the report; and 3) the quality of the tradelines added. In his experience, Airy has seen boosts from single credit cards ranging from 12 points to hundreds.

Savings Example

The higher your FICO® scores the less you can expect to pay for your loan. For example, on a \$216,000 30-year, fixed-rate mortgage:

If your FICO score is	Your interest rate is	and your monthly payment is
760 - 850	5.8%	\$1,267
700 - 759	6.02%	\$1,298
680 - 699	6.2%	\$1,323
660 - 679	6.41%	\$1,353
640 - 659	6.84%	\$1,414
620 - 639	7.39%	\$1,494

Actual National Interest Rates

As you can see in this example using today's national rates, a person with a FICO® score of 760 or better will pay \$227 less per month for a \$216,000 30-year, fixed-rate mortgage than a person with a FICO® score of 620 □□□ that's a savings of \$2,724 per year. You can see how essential improving your credit scores can be if they are low, and also how important it is to keep them high if they are good.

- MyFICO.com

Figure 2 Savings Example from BoostMyScore. Net's website¹⁴

Before opening, BoostMyScore.net hired a law firm to research the legality of credit piggybacking, from which it received assurance that “the practice is legal under current federal regulations and law.”¹⁵ The lawyer analyzed whether the company was in compliance with the Truth in Lending Act, the Fair Credit Reporting Act, and the Fair and Accurate Credit Transaction Act, and concluded that none of these regulations apply to its business.¹⁶



Figure 3 The premier credit boosting product offered by BoostMyScore.net¹⁷

¹⁴ Supra note 10.

¹⁵ See Appendix for a copy of the opinion letter by counsel to BoostMyScore.net.

¹⁶ It is worth noting that the lawyer’s opinion does not mention compliance with the Credit Repair Organizations Act (CROA). The copy of the letter from counsel did not include a date, but it is the author’s belief that it predated the passage of this act. See the Appendix for a later legal opinion issued to client, asserting that BoostMyScore.net is not a credit repair organization.

¹⁷ BoostMyScore.net - Your Credit Advisor - Decide, <http://boostmyscore.net/decide.html>

On its website, BoostMyScore.net offers a shopping list of credit card accounts, boasting high credit limits and years of perfect payment history. For each offering, the website lists such details as the card type, limit, duration of perfect history, balance, reporting date, along with the corresponding cost to “rent” a space as an authorized user of the card. Most credit cards limit the number of authorized users that can be added, so each of the cards has limited availability of authorized user accounts to rent. Figure 3 shows a listing from the website for one of the premier credit card offerings, “The American Express® Black Boost,” and Figure 4 displays several other card listings.

*Credit Bureau Reporting Date						
Card Type	Limit	Perfect History	Balance	Date*	Cost	Availability
01 CitiBank MC	\$45,200.00	19 years 1 month	\$0.00	monthly on the 28th	\$1,500.00	Sold out until 4/30/09 prepayment available
02 CitiBank MC	\$24,900.00	18 years 3 months	\$0.00	monthly on the 4th	\$1,400.00	Sold out until 5/08/09 prepayment available
03 CitiBank MC	\$18,700.00	19 years 2 months	\$0.00	monthly on the 11th	\$1,400.00	1/10 spots available

Figure 4 Other score boosting products from BoostMyScore.net¹⁸

3. The Introduction of FICO 08

The effect of credit piggybacking is most directly felt by creditors. In the modern credit system, lending decisions are based on elaborate actuarial models that focus on quantitative

¹⁸ Id.

measures of consumer creditworthiness. Since creditors are the customer-base for Fair Isaac Corporation, the company quickly became aware of the credit piggybacking practice. However, it was unable to efficiently retrofit its product to solve the piggybacking problem for existing clients.¹⁹ Instead, the company opted to address the problem by issuing a new version of the FICO score. This new version would fix the credit piggybacking loophole by excluding authorized user accounts, and incorporate various other upgrades expected to improve the formula's predictive power.²⁰ In the words of Tom Quinn, a Fair Isaac Corporation Vice President—in newer versions of FICO “[t]he entire [authorized user] account will be bypassed,” eliminating the benefit of credit piggybacking.²¹

However this all or nothing treatment of authorized user accounts would not be able to differentiate between the legitimate uses of authorized accounts and illegitimate credit piggybacking. The Fair Isaac Corporation even acknowledged that such a change would impact a large segment of the consumer population: “[o]ur analysis during development showed that 30% of the population has an account on their report that lists them as an authorized user.”²² Although the full extent of the piggybacking problem is unknown, it is likely that the overwhelming majority of authorized user accounts are legitimate.

The Fair Isaac Corporation publicly announced its planned changes for the FICO 08 formula in June 2007. According to the company's original timetable, the new formula would be available to the credit reporting bureaus as early as September 2007.²³ And despite the antitrust litigation that was ongoing at the time between Fair Isaac Corporation and the three major credit bureaus regarding competition from VantageScore (discussed below), all three bureaus were planning to adopt FICO 08 between late 2007 and early 2008.²⁴

¹⁹ J. Ulzheimer and E. Davidson. “Consumer Alert: FICO Scores Dropping Authorized User Accounts,” http://www.credit.com/credit_information/credit_report/Consumer-Alert-FICO-Formula-Changes.jsp

²⁰ Id.

²¹ Id.

²² Id.

²³ “Understanding FICO 08,” <http://www.money-zine.com/Financial-Planning/Debt-Consolidation/Understanding-FICO-08/>

²⁴ Supra note 18.

The apparent Fair Isaac Corporation’s victory over the credit piggybackers was embraced by the media with headlines such as “Putting a Stop to a Credit Ruse”²⁵ and “Credit-Rating Standard Tightens.”²⁶ However unforeseen problems with the upgrade would emerge.

4. Compliance with Regulation B of the ECOA

BoostMyScore.net and other credit building companies were vocal in their criticism of the FICO 08 changes.²⁷ In January 2008, attorneys working for BoostMyScore.net were asked to research whether the elimination of authorized user accounts in FICO 08 could put creditors in violation of Regulation B of the Equal Credit Opportunity Act (ECOA).²⁸ The attorneys found a Regulation B compliance issue, and BoostMyScore.net promptly brought this matter to the attention of the FTC and other government regulatory bodies that interact with the Fair Isaac Corporation.²⁹

Regulation B,³⁰ was issued by the Board of Governors of the Federal Reserve System under authority granted by the ECOA (15 U.S.C. 1601 *et seq*). The goal of the regulation is to provide more detailed guidance on how to implement the anti-discriminatory goals of the ECOA. Section 202.6(b) lists rules about what specific pieces of information should be used “in any system of evaluating the creditworthiness of applicants.”³¹ One of the requirements is listed in §202.6(b)(6) which is reproduced below:

²⁵ Kenneth R. Harney. “Putting a Stop To a Credit Ruse,” June 2007, http://www.washingtonpost.com/wp-dyn/content/article/2007/06/15/AR2007061500917_pf.html

²⁶ Jaclyne Badal. “Credit-Rating Standard Tightens,” June 2007, <http://online.wsj.com/article/SB118118471927527461.html>

²⁷ “FICO 08 Arrives in '09,” Feb. 2009, http://boostmyscore.net/FICO_08_Arrives_in_09.html; Jeremy M. Simon. “‘Piggybacking’ gets clemency from FICO,” July 2008, <http://www.creditcards.com/credit-card-news/piggybacking-fico-credit-score-authorized-user-1265.php>

²⁸ Supra note 7.

²⁹ Id.

³⁰ 12 C.F.R. 202

³¹ 12 C.F.R. 202.6(b)

AUTHORIZED USER ACCOUNTS

“§202.6(b)(6) Credit history. To the extent that a creditor considers credit history in evaluating the creditworthiness of similarly qualified applicants for a similar type and amount of credit, in evaluating an applicant's creditworthiness a creditor shall consider:

- (i) The credit history, when available, of accounts designated as accounts that the applicant and the applicant's spouse are permitted to use or for which both are contractually liable”³²

The ECOA, passed in 1974 prohibits any discrimination by creditors, at any point within the lending process, against several protected classes. By its terms, all persons defined as creditors under §202.2(l) fall within its regulatory scope. Under its definition, “[c]reditor means a person who, in the ordinary course of business, regularly participates in a credit decision, including setting the terms of the credit.”³³ Although the Fair Isaac Corporation does not fall within the definition of a creditor, the majority of its customers—who typically use its formula to evaluate consumers’ credit worthiness—are creditors under the ECOA. If FICO 08 does not satisfy the ECOA’s required criteria in its evaluation of credit applicants, those creditors who want to use FICO to make lending decisions would be unable to do so without risking a violation of the ECOA—a risk no prudent lender would take.

One surprising caveat to this incident, is that public awareness of the compliance issue may have been avoided if Fair Isaac’s public relation team had been less forthcoming in explaining how it planned to eliminate credit piggybacking in FICO 08. If the Regulation B issue had not reached the attention of the FTC and Federal Reserve, these changes to the formula may slipped through the cracks, due to the secrecy with which the Fair Isaac Corporation holds its proprietary information. But ultimately since this issue did become public, the Fair Isaac Corporation was forced to take a step back and acknowledge its mistake.

³² 12 C.F.R. 202.6(b)(6)

³³ 12 C.F.R. 202.2(l)

5. Fair Isaac Corporation Admits its Mistake

In July 2008, before the U.S. House of Representatives Subcommittee on Oversight and Investigations, the Fair Isaac Corporation issued a written statement explaining that the proposed FICO 08 changes that eliminated authorized user accounts had been an attempt “to protect lenders and consumers from a new type of credit repair practice known as ‘piggybacking’ or ‘tradeline renting’, which has received national attention from news media since March 2007.”³⁴ The statement continued with the line reproduced below:

FAIR ISAAC’S REVERSAL

“After consulting with the Federal Reserve Board and the Federal Trade Commission earlier this year, Fair Isaac has decided to include consideration of authorized user tradelines present on the credit report in the FICO 08 model. Our scientists have devised a method to consider these tradelines while materially reducing the negative impact that could arise from piggybacking”³⁵

Despite this setback, the Fair Isaac Corporation claims it has found another way to eliminate piggybacking, though this time they have been less forthcoming with the details of the new technique. According to a Fair Isaac press release, the “FICO® 08 score also incorporates new, patent-pending technology that protects lenders from authorized user (AU) abuse, while still supporting regulatory compliance.”³⁶ Since lenders want continued ECOA compliance, the new technology “includes [authorized user] data in the calculation of scores, while reducing potential impact from tampering.”³⁷ This solution allows the “more than 50 million US consumers [who] are legitimate authorized users” to continue to benefit, and at the same time stops credit piggybackers.³⁸

³⁴ “Credit Scoring Models and Credit Scores.” Before the U.S. House of Representatives, Committee on Financial Services, Subcommittee on Oversight and Investigations, Washington, D.C. July 29, 2008.

³⁵ Id.

³⁶ “FICO 08 score delivers predictive boost where lenders need it most,” <http://www.fairisaac.com/NR/exeres/E098C595-545F-4DDD-A6CF-449EA685E8E1,frameless.htm>

³⁷ Id.

³⁸ Id.

Although Fair Isaac Corporation has not explained how it intends to count authorized user accounts while excluding piggybackers, Mr. Airy has contemplated how they may be able to differentiate piggybackers from other authorized users.³⁹ According to Mr. Airy, when a credit card company reports a credit card's history to the bureaus, the date that a user was authorized is reported. If this piece of information were factored into the score calculation, a newly authorized user would not receive the benefit of an account's long credit history, which provides much of the boost of credit piggybacking. Furthermore, credit scores suffer a 15 point hit for having a new account with no payment history, so for most consumers, piggybacking could initially harm their score. The only people who would still benefit from piggybacking are those who have maxed out all of their lines of credit. For these users, the decrease in their utilization ratio would likely outweigh the new account penalty.⁴⁰

When FICO announced its plans to eliminate credit piggybacking, Mr. Airy's business took a substantial hit—many customers were discouraged by Fair Isaac's claim that piggybacking was over. Through the ups and downs of his business, Mr. Airy has maintained a pragmatic outlook. He recognizes that with the upcoming changes to the FICO scoring algorithm, BoostMyScore.net's business model is winding down. At the time that FICO 08 was initially announced, he anticipated that he would remain in business for another year and a half; however, that time has already elapsed, due to the compliance issues that emerged. But since adoption of FICO 08 is still proceeding at a slow pace, the piggybacking business may continue to defy expectations.

6. About the Fair Isaac Corporation

The Fair Isaac Corporation traces its beginning to the 1950s, when a partnership was created between mathematician, Bill Fair and engineer, Early Isaac.⁴¹ The two proposed that the use of data analysis could improve the decision-making processes of businesses, particularly

³⁹ Supra note 7.

⁴⁰ Id.

⁴¹ Supra note 1.

those in the credit industry. At that time, Fair was developing statistical techniques to build predictive models of behavior. He understood that credit decisions involve hundreds of factors, creating a vast number of possible outcomes. But he recognized that with the use of multivariate analysis, a scoring algorithm could be developed that greatly simplify the analysis.⁴² This task was aided by concurrent developments in the computer industry, which allowed increasingly complex calculations to be performed at quicker speeds.

During the 1950s, credit and loan making decisions were generally made on a subjective basis. Banks and other lenders were usually based locally, and the lending process was more personal in nature. This personalized system, in addition to being less consistent, allowed the biases of bank agents to influence their decisions. Bill Fair saw a better way to manage credit risk, though it took creditors some time to realize it. In 1958, the company's first credit scoring system was only able to attract a single customer among the fifty largest credit-granting businesses in the United States.

Although Fair Isaac Corporation is today best known for its credit scoring applications, the company received its first big break in 1972 for a different application: developing an auditing algorithm for the Internal Revenue Service. The company was contracted to produce a program to more accurately identify tax evaders, thus allowing the IRS to more efficiently choose which taxpayers to audit. Shortly thereafter, the IRS was able to reduce audits by a third, while posting a higher level of uncovered payments.⁴³ The unifying theme underlying all of Fair Isaac Corporation's endeavors is the incorporation of statistical data analysis techniques to create predictive models of behavior. This specialized focus led the company to develop scoring systems for employee hiring practices, insurance scoring systems,⁴⁴ strategic decision making,⁴⁵

⁴² "Fair, Isaac and Company – Company History," <http://www.fundinguniverse.com/company-histories/Fair-Isaac-and-Company-Company-History.html>

⁴³ Id.

⁴⁴ "Insurance," <http://www.fico.com/en/Industries/Insurance/Pages/default.aspx>

⁴⁵ "HSBC Adopts Fair Isaac Strategy Science Framework to Fuel Growth in Asia-Pacific Region," Aug. 2006, <http://www.fairisaac.com/fic/en/news/press-releases/HSBC-Adopts-Fair-Isaac-Strategy-Science-Framework-to-Fuel-Growth-in-Asia-Pacific-Region.htm>

as well as more sophisticated credit scoring products, which have evolved into the present day FICO score.⁴⁶

A variety of factors contributed to Fair Isaac’s dominance of the credit scoring industry. During the 1970s the use of credit cards increased dramatically. Evaluating credit limits took on greater importance for lenders trying to manage risk. Furthermore, with the passage of the Equal Credit Opportunity Act (ECOA) in 1974, creditors had to be careful about any discriminatory practices that their traditional lending system may have enabled. As a consequence, lenders were forced to abandon many of their old practices, which had long disguised discriminatory biases. Another advantage of the Fair Isaac algorithms was their use of objective metrics, which avoided the risk of discrimination through disparate treatment.

During the 1970s, many creditors adopted credit scoring formulas. Initially, a custom-tailored formula was developed for each company to meet their desired risk profile.⁴⁷ However, custom-designed credit risk systems are far more expensive, and these early embodiments only used the customer data from individual companies. In the mid-1980s, the national credit bureaus arose as repositories for vast amounts of consumer information, from which Fair Isaac developed a generic scoring system. Rather than relying on the experience of just one lender, the experiences of millions of lenders could be mined in search of patterns of consumer behavior. Thus, the FICO score was positioned to become the dominant metric for evaluating consumer credit.

7. The Market for Credit Scoring

It is important to understand the distinctions between the different entities that form the backbone of the credit system. The credit bureaus and Fair Isaac Corporation are not themselves creditors, and are not directly subject to the authority of the Equal Credit

⁴⁶ “FICO® score,” <http://www.fico.com/en/Products/Scoring/Pages/FICO-score.aspx>

⁴⁷ Supra note 10 at “How Credit Scoring Came into Being.”

Opportunity Act (ECOA).⁴⁸ However, these businesses are providing a service for creditors, who are under the regulation of the ECOA and other laws, and if they want their products to meet the needs of their customers, they need to ensure that use of their credit scoring products will comply with all anti-discriminatory laws.

a. FICO's Dominance

The Fair Isaac Corporation developed, and closely controls the formula used to calculate the FICO score. Although the details of the algorithm used to calculate FICO scores are the proprietary information of the Fair Isaac Corporation, the following information has been disclosed to the public to help consumers better understand their scores.

DEVELOPMENT OF THE FICO SCORING MODEL

“Creating the FICO scoring model requires two samples of credit reports two years apart for the same randomly selected depersonalized set of consumers, provided by one of the national credit reporting agencies. Our analytic scientists then analyze the data in the earlier data set to isolate and prioritize factors that consistently predict the credit account performance noted two years later in the later data set. Those factors found to be most powerful and consistent in predicting credit performance, individually and in combinations, form the basis for a complex mathematical algorithm which becomes the predictive scoring model.”⁴⁹

The figure below lists the five types of information that factor into the score, along with the approximate contribution of each to a typical consumer's FICO score.

⁴⁸ §202.2(l). “Creditor means a person who, in the ordinary course of business, regularly participates in a credit decision, including setting the terms of the credit. The term creditor includes a creditor's assignee, transferee, or subrogee who so participates. For purposes of §202.4(a) and (b), the term creditor also includes a person who, in the ordinary course of business, regularly refers applicants or prospective applicants to creditors, or selects or offers to select creditors to whom requests for credit may be made. A person is not a creditor regarding any violation of the Act or this regulation committed by another creditor unless the person knew or had reasonable notice of the act, policy, or practice that constituted the violation before becoming involved in the credit transaction. The term does not include a person whose only participation in a credit transaction involves honoring a credit card.”

⁴⁹ Supra note 33.

Table 1 FICO Factors⁵⁰

Payment history	35%
Outstanding debt	30%
Length of credit history	15%
Pursuit of new credit	10%
Mix of types of credit	10%

Negative marks on a consumer’s payment history are evaluated based on the recency, frequency, and severity of any incidents. The outstanding debt metric weighs the total amount owed on all credit lines against the available credit limits—using a high percentage of their limit will hurt a borrower’s score.⁵¹ The age of the oldest account, as well as the average account age is also considered. The number of times and how recently a consumer has applied for, or opened new lines of credit, and in this way, “shopping around” for credit could potentially harm a borrower’s score.⁵² The remaining factor considers whether a consumer has a mix of different types of credit, though the benefit of having such a mix is not clear.⁵³

b. Competition From VantageScore

In March 2006, the three major credit bureaus announced their participation and ownership in a joint venture to create an alternative generic credit scoring system called VantageScore. The motivation for the project is clear: each time the bureaus calculate a credit score using the FICO model, they are required to pay a fee to the Fair Isaac Corporation. This business is highly profitable for Fair Isaac, consisting of approximately 65% of its operating profits, according to analysts.⁵⁴ The credit bureaus had previously attempted to devise proprietary scoring models; however these initiatives were uncoordinated and poorly received because each agency used a different system with a different range.⁵⁵ The companies realized that to create a viable alternative to FICO, they would need to collaborate.

⁵⁰ Id.

⁵¹ Supra note 10 at “The Five Most Important Factors.”

⁵² Id.

⁵³ Id.

⁵⁴ Id at “VantageScore—A Revolution or Just More of the Same?”

⁵⁵ Damon Darlin. “The Credit Game Is Getting a Second Scorekeeper,” July 2006, <http://www.nytimes.com/2006/07/08/business/yourmoney/08money.html?pagewanted=all>

Table 2 VantageScore Factors⁵⁶

Payment history	32%	Whether your payments are satisfactory, delinquent, or derogatory
Utilization	23%	The percentage of credit that you have used or that you owe on your accounts
Balances	15%	The amount of recently reported balances, both current and delinquent
Depth of credit	13%	The length of your credit history and the types of credit you have
Recent credit	10%	The number of recently opened accounts and credit inquiries
Available credit	7%	The amount of available credit on all your accounts

The ranges of each scoring model differ slightly: FICO scores run from 300 to 850, while VantageScores are between 501 and 990. The factors used to calculate a consumer's VantageScore substantially overlap with the FICO factors, but with different weights assigned. Payment history is counted approximately the same in each system, but FICO assigns greater weight to the length of credit history, while VantageScore gives more consideration to the amount and usage of available credit (compare the chart for VantageScore with that for FICO).

Regardless of whether or not VantageScore is a better predictive model than FICO, the Fair Isaac Corporation holds a substantial competitive advantage because of the high barriers to entry in the credit scoring industry. FICO scores "are deeply embedded in the complex, highly automated formulas that lenders use to evaluate current and potential borrowers."⁵⁷ Credit scoring expert, John Ulzheimer compares switching models to "spending \$10,000 to replace a \$1 part, and the \$1 part isn't even broken."⁵⁸ FICO scores have become the standard metric for evaluating credit quality, not just for lenders, but for the Wall Street institutions participating in transactions on secondary markets for commoditized debt obligations.

Despite these substantial structural advantages, the Fair Isaac Corporation was still threatened by this collaboration among its rivals. In October 2006, Fair Isaac brought suit in the U.S. District Court in Minnesota against VantageScore Solutions and the three credit bureaus that own it, alleging multiple counts of unfair competition, trademark infringement, deceptive

⁵⁶ Supra note 53.

⁵⁷ Id.

⁵⁸ Id.

trade practices, and illegal attempts to monopolize.⁵⁹ Among other claims, Fair Isaac pleads that the overlap in the score ranges was an attempt to confuse customers, to unfairly profit from its goodwill, and violate its trademark.⁶⁰

In early 2007, Fair Isaac served discovery requests on VantageScore, seeking the details of the VantageScore algorithm.⁶¹ Worried that the secrets of their proprietary formula may be revealed to their main competitor, the defendants moved for a protective order shielding these specific items from discovery, and requested a protective order generally shielding highly confidential information from discovery.⁶² In July 2007, the magistrate judge ruled against the defendant's motion and granted the plaintiff's motion to compel discovery. The defendants appealed to the district court, which agreed to stay the order to prevent the defendants' objections from becoming moot. In its ruling in September 2007, the district court went on to overrule the defendant's objections, sustaining the magistrate's ruling. In March 2008, the case again came before the district court, which denied the defendants' motions for partial summary judgment on the pleadings and for partial summary judgment on the antitrust claims.⁶³

During the ongoing litigation over VantageScore, the conflict between the companies expanded when Equifax announced a halt to its plan to implement FICO 08.⁶⁴ The company directly attributed this decision to the litigation over VantageScore. According to Equifax spokesman, David Rubinger, "[o]ur relationship with FICO remains strained as long as FICO is suing over VantageScore."⁶⁵ While discussing the company's decision not to implement FICO 08, Equifax chief marketing officer, Paul Springman conceded that "[Fair Isaac wasn't] happy

⁵⁹ Complaint. 2006 WL 6201833 (D.Minn.)

⁶⁰ "FICO Creator Sues National Credit Agencies Over VantageScore," Oct. 2006, <http://www.foxnews.com/story/0,2933,220155,00.html>

⁶¹ 2007 WL 2791168 at *1 (D.Minn.).

⁶² Id.

⁶³ 2008 WL 623120 (D.Minn.).

⁶⁴ Pamela Yip. "No more free rides," Feb. 2008, http://www.signonsandiego.com/uniontrib/20080217/news_lz1b17score.html

⁶⁵ Id.

about it and our customers weren't happy about it, but we decided this was our stake in the ground.”⁶⁶

Despite the parties' tenacity in this dispute, business interests took priority over the litigation. In June 2008, Fair Isaac and Equifax announced “that they have established a partnership to develop and sell advanced analytics and scoring solutions for businesses and consumers.”⁶⁷ Furthermore, in a reversal from Equifax's earlier statements, the two companies planned to “accelerate testing and roll-out of the FICO 08 model for Equifax customers.”⁶⁸ In the same press release, Fair Isaac made the announcement that it would “separately” drop Equifax from its VantageScore lawsuit.⁶⁹

Since then, the case has been proceeding through an excruciatingly slow discovery phase. Both sides seem determined to use the full arsenal of legal weapons available through the discovery process to compel disclosure of each others' valuable trade secrets. In the latest court opinion in January 2009, another set of discovery motions came before the district judge.⁷⁰ The subject of this latest disagreement is whether two Fair Isaac employees can be compelled during deposition to answer questions relating to the new business initiative with Equifax. The two employees were preparing analyses and projections “comparing what Fair Isaac's scoring business would look like depending on whether or not the company entered into” the partnership with Equifax.⁷¹ The magistrate judge ruled against the defendants' motion to compel, and the defendants objected.⁷² In this latest motion, the district judge overruled each of the defendants' objections.⁷³

⁶⁶ Russell Grantham. “Equifax, partner call truce,” June 2008, http://www.ajc.com/services/content/business/stories/2008/06/12/equifax.html?cxntlid=inform_sr

⁶⁷ “Equifax and Fair Isaac Enter Partnership to Accelerate Development and Delivery of New Analytic Solutions,” June 2008, <http://www.fairisaac.com/fic/en/news/press-releases/fair-isaac-and-equifax-enter-partnership.htm>

⁶⁸ Id.

⁶⁹ Id.

⁷⁰ 2009 WL 161247 (D.Minn.).

⁷¹ Id. at *1.

⁷² Id.

⁷³ Id. at *3.

8. Regulatory Landscape for Credit Scoring

a. “Disparate Impact”

Regulation B of the ECOA contemplates two main types of credit evaluations: traditional judgment-based decisions, and credit-score-based decisions. In the modern credit system, lending decisions are typically made through a process that relies heavily on quantitative factors, such as credit scores, rather than subjective evaluations. For lenders, this reduces the possibility that an applicant will be denied credit as a result of direct discrimination that treats applicants different based on one of the ECOA’s prohibited factors, a practice sometimes referred to as “disparate treatment.”⁷⁴ The more probable ECOA compliance issue for modern lenders arises under the “disparate impact theory.” See the box below for a more detailed explanation of disparate impact. When the lending transaction involves residential real estate, the Fair Housing Act (FHA) prohibitions on discrimination apply, along with those of the ECOA.⁷⁵

DISPARATE IMPACT

“Most fair lending cases present claims of ‘disparate treatment,’ which is a form of intentional discrimination. A more controversial legal theory contends that even policies and practices that are adopted and implemented without a discriminatory purpose can be unlawful if they have a discriminatory impact. A plaintiff can thus challenge a racially neutral policy and, to support the claim, present statistical evidence demonstrating that the policy detrimentally impacts a significantly greater percentage of a particular racial or ethnic group than it does Whites. To avoid a finding of liability, the defendant can show that, notwithstanding this differential impact, the policy is based on sound business reasons or, as sometimes is said, a ‘business necessity.’ A plaintiff can still prevail if she can demonstrate that the business purpose can be achieved by policies that have a significantly smaller differential impact.”⁷⁶

⁷⁴ “Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit,” Federal Reserve Board. August 2007, <http://www.federalreserve.gov/boarddocs/rptcongress/creditscore/creditscore.pdf> at 51. The ECOA prohibits discrimination on the basis of race, color, religion, sex, national origin, age, and marital status.

⁷⁵ Id. at 50.

⁷⁶ <http://www.klgates.com/newsstand/Detail.aspx?publication=4009>

b. Credit Scoring System Criteria

Section 202.2(p) of Regulation B of the ECOA established several criteria for the development of a credit scoring system.⁷⁷ First, the data set used to derive the formula must consist of both creditworthy and non-creditworthy applicants who recently applied for credit.⁷⁸ Second, the system must be designed to serve the legitimate business interests of the creditor using the system.⁷⁹ Third, accepted statistical methods must be used to develop the formula. And fourth, the system must be periodically revalidated and adjusted to maintain its predictive capacity.⁸⁰

c. Credit Scoring and Its Effects on the Availability and Affordability of Credit

As the use of credit scores has expanded beyond just the traditional lending markets and into other fields such as the insurance industry, there are growing concerns that minorities are impacted unfairly by the methodologies of credit-scoring models. With the passage of The Fair and Accurate Credit Transactions Act of 2003 (FACTA), the Federal Reserve Board (FRB) and the Federal Trade Commission (FTC) were required to study how credit scoring was affecting the cost of credit and insurance for minorities populations, and whether these predictive models were accurate for these groups.⁸¹ Section 215 of FACTA further directed the FRB and FTC to study whether credit scoring has a differential impact on the groups protected under the Equal Credit Opportunity Act (ECOA).⁸² Few studies have been conducted into the potential disparate impact of credit scoring, in part because it is illegal for creditors to collect the demographic information on race or national origin that would be needed to conduct this analysis.⁸³

⁷⁷ 12 C.F.R. 202.2(p).

⁷⁸ Supra note 73 at 52.

⁷⁹ Id.

⁸⁰ Id.

⁸¹ Section 215 of The Fact Act, Public Law 108-159, enacted December 4, 2003.

⁸² Supra note 73.

⁸³ Hancock, P. and Brody, M. “Disparate Credit Scores Not a Proxy for Unlawful Discrimination Says FRB,” Aug. 2007, <http://www.klgates.com/newsstand/Detail.aspx?publication=4009>

To conduct this study, the FRB collected the full credit records of over 300,000 people as of June 2003, along with their credit records eighteen months later.⁸⁴ Since the FRB did not have access to the algorithms underlying the proprietary scoring models, it created its own simplified credit model for use in this study. After creating this model, its predictive success was evaluated with respect to different breakdowns of the population, to consider whether use of these factors in forming a credit score was having a disparate effect on any protected groups. In effect, the FRB was subjecting its credit model to the disparate impact analysis described above. After conducting this study, the FRB found that the credit scores were not mere proxies for race, and actually served as good indicators of loan performance.⁸⁵

STRONGER CORRELATION TO PERFORMANCE THAN TO RACE

“For race and ethnicity, almost all of the credit characteristics . . . are more correlated with performance than with demographic characteristic . . . regardless of the specific group considered.” Report at 101. ‘Indeed, most credit characteristics are only minimally correlated with race and ethnicity, many are not correlated at all, and none are highly correlated. . . . [T]he characteristics that are most correlated with both performance and race are all related to past payment history. Each of these characteristics is also highly correlated with performance.’ *Id.* at 102.”⁸⁶

Going through the logical steps required to prove a disparate impact claim under the ECOA, as described above, the first prong of the test asks whether credit scoring detrimentally impacts a protected group. The empirical data clearly indicates that, blacks and hispanics have significantly lower scores than non-hispanic whites, satisfying the first part of the test.⁸⁷ Notwithstanding this showing of detrimental impact, a lender can avoid liability by showing that the allegedly discriminatory policy—in this case, using credit scores to make lending decisions—is a business necessity. Since the study indicates that the models are actually accurate predictors of behavior that are not mere proxies for race, a lender would likely meet this

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ *Id.* (quoting Federal Reserve Board Report)

⁸⁷ *Id.*

burden.⁸⁸ A plaintiff would still have the chance to argue that the business policies could be achieved in a manner that has a smaller differential impact. However, after contemplating this issue the FRB was unable to identify an alternative manner that could be a viable alternative.⁸⁹ Thus the FRB's analysis indicates that credit scoring models would likely be found compliant with disparate impact analysis under the ECOA.

CREDIT SCORING BIASES

“Consistently, across all three credit scores and all five performance measures, blacks, single individuals, individuals residing in lower-income or predominantly minority census tracts show consistently higher incidences of bad performance than would be predicted by the credit scores. Similarly, Asians, married individuals, foreign-born (particularly, recent immigrants), and those residing in higher-income census tracts consistently perform better than predicted by their credit scores.”⁹⁰

The report concluded that “there is little evidence from the analysis here that any of the credit characteristics included in the FRB base model embeds negative differential effects for any racial or ethnic group.”⁹¹ However, “[u]nlike race and ethnicity . . . there is some evidence that the FRB base model credit characteristics may embed some disparate effects by age, but the effect appears small.”⁹² Surprisingly, the FRB's conclusion from this study is that a litigant bringing a disparate impact claim would find a stronger basis in alleging age discrimination than race discrimination. However, given the study's other finding that the models were strongly predictive of performance, even for the age-based claim the disparate impact would probably be considered justifiable as a business necessity with no clear alternative.⁹³

⁸⁸ Id.

⁸⁹ Id.

⁹⁰ Supra note 73 at 89.

⁹¹ Id. at 113.

⁹² Id. at 115.

⁹³ Supra note 82.

Appendix

Letter from Counsel of BoostMyScore.net

Professional Legal Opinion for:

BoostMyScore.NET, LLC
2243 Irving St
Denver, CO 80211

To Whom It May Concern:

As far as I have been able to determine, your operations are currently legal. Based on my review of the FTC's web site, various news articles, and news stories, I believe the practice of "piggybacking" is currently legal. Additionally, it is my opinion that the Truth in Lending Act, the Fair Credit Reporting Act, and the Fair and Accurate Credit Transaction Act do not appear to apply to your current business operations.

The FTC has skirted the issue and has not issued an opinion either way on the legality of the practice. The Mortgage Lenders' Association considers the practice "fraudulent", but that is only the opinion of that association. The opinion carries no legal weight. I have not been able to find any case law that has dealt with this issue and decided it one way or the other.

Therefore, at the present time, it is my professional opinion that the practice is legal under current federal regulations and law.

Sincerely,

Kent P. Long
Attorney at Law
Theodore P. Watson and Associates, LLC
1001 South Monaco Parkway, Suite 310
Denver, CO 80224

Subsequent Letter from Counsel of BoostMyScore.net

I am writing you on behalf of Mr. Bill Airy, owner of Boost My Score dot Net, LLC. Mr. Airy has advised me that he met with you approximately three weeks ago after applying for accreditation from your agency. I understand from Mr. Airy that you still have questions about the nature of his business operations.

Mr. Airy's business is that of a broker only. The scope of Mr. Airy's business is to connect a person who desires to become an authorized user on another person's credit card with a person who is independently renting authorized user positions on one or more credit cards. Mr. Airy does not engage in any business activity that attempts to change a person's credit score by interceding with one or more national credit reporting bureaus. Additionally, Mr. Airy makes no representation that the services performed by his company will increase or in any other way improve anyone's credit score. As such, it is our position that Mr. Airy's business is not a credit repair organization as defined by either the federal Credit Repair Organization Act (Pub. Law 90-321) or the Colorado Credit Repair Organization Act (§12-14.5-101, *et seq.* C.R.S.).

If you have additional questions or need further information, please contact me at your convenience.

I do not wish to or intend to give up attorney client privilege by my dissemination of this letter.