Insight

A Public Credit Reporting Agency: Evaluating a Biden Campaign Proposal

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Executive Summary

- In late 2020 the Biden presidential campaign endorsed a plan to eliminate the private credit reporting industry and replace it with a new public agency to provide the same service.
- Proponents of a public credit reporting agency point to criticisms of the services provided by private industry but fail to articulate why these problems cannot be solved by legislation or why a government agency would necessarily perform any better.
- The current system of private credit reporting bureaus in competition with each other has fostered innovation, greater access to credit, reduced cost of credit, diversified products, and provided a stable lending environment relatively immune from political headwinds.

Introduction

Perhaps the most crucial question banks and other lenders face is whether a prospective borrower, an individual or business, is likely to default on a loan. The need to quantify creditworthiness led to the creation of credit scoring and credit reporting.

The private credit reporting industry has been a legislative focus since the 1970 Fair Credit Reporting Act, and Congress continues to propose further refinement (see, for example, the Comprehensive CREDIT Act of 2020). Increasingly popular, however, is the idea that this entire private industry be abandoned via the creation of a *public* credit reporting agency as seen prominently in the manifestos of several Democratic primary contenders, including that of then-candidate Joe Biden. The Biden campaign's July 2020 "Biden-Sanders Unity Task Force Recommendations" included, among many other recommendations, the creation of a public credit reporting agency "to provide a non-discriminatory credit reporting alternative to the private agencies," that all federal lending programs would be required to adopt. The Biden campaign later released proposals based on policy recommendations of the think tank Demos – although Demos goes far further in that its public credit reporting agency would not be an "alternative" to current private providers but would "replace" this market segment.

One hundred days into the Biden presidency a public credit reporting agency has not been proposed by either the administration or a Democrat-controlled Congress, figuring in neither COVID-relief nor infrastructure legislative proposals. This says nothing about future proposals; and in advance of that time, it is worth considering the implications of such a significant intervention in the economy and the merits or drawbacks of that action. Beyond the significant adverse implications for a developed industry (and the related hit to jobs and the real economy), a public credit reporting agency would have little incentive to innovate, would be no more subject to oversight or accountability It would, however, come at enormous cost to the taxpayer to implement and maintain and is unlikely to provide a better service to consumers than the developed credit industry

currently does.

Context

The terms "credit score" and "FICO score" are often used interchangeably, although a FICO score is simply the best known and most widely used example of a credit score. The Fair Isaac Corporation—known more simply as FICO—was founded in 1956 to provide lenders a quantifiable measure of creditworthiness. Today, FICO remains the chief provider of credit scores, with the company estimating that 90 percent of top lenders use a FICO score to make lending decisions. Further, FICO's model is currently the only one approved for use by the government-sponsored entities Fannie Mae and Freddie Mac.

FICO assesses the likelihood a consumer will repay a credit obligation and provides a personalized credit score. That credit score is calculated for the three major credit-reporting agencies: Equifax, Experian, and Trans Union. These credit reporting agencies, also known as credit bureaus, assemble a wide-ranging credit report that incorporates a credit score in addition to other factors they deem to impact creditworthiness. Lenders then use these credit reports as a basis for lending decisions. Equifax, Experian, and Trans Union compete to provide this data-capture service to lenders, and an individual's FICO score may differ as provided from bureau to bureau, usually as a result of timing differences or access to different underlying data.

In the absence of an articulated legislative proposal, details on how a public credit reporting agency would work remain scarce. (Biden's initial campaign proposal for a public credit reporting is one sentence long.) The Demos proposal does not provide much more in the way of specificity beyond that the agency would be housed in the Consumer Financial Protection Bureau (CFPB) and that there would be a seven-year transitional period before the full replacement of private credit reporting agencies.

Is There a Need for a Public Credit Reporting Agency?

Proponents of a public credit reporting agency usually point to flaws in the services provided by Equifax, Experian, and Trans Union—most notably credit report inaccuracies and uneven racial access to credit. What is curious to note is that all of these arguments in favor of a public credit reporting agency, valid or not, are criticisms solely of the current private credit reporting industry. These arguments do not, in and of themselves, point to the creation of a public credit reporting agency. Proponents of a public agency therefore seem to make a number of fundamental assumptions that do not hold up to scrutiny. If the private industry is fundamentally flawed, would a government approach necessarily perform better? If the current system only needs minor tweaking, why is the solution not legislation?

Congress has addressed concerns with regard to credit accessibility and reporting on many past occasions without resorting to creating a new government entity to replace the industry. Proponents of a public credit registry have seemed to argue that the industry's use of algorithms to predict creditworthiness makes legislative changes, short of a full government replacement, ineffective despite the private sector's provision of increasing transparency on the how credit scores are collected and calculated. Congress is perfectly capable of addressing the private sector's use of algorithms to predict creditworthiness via legislation if there is a perceived need, including, for example, by instructing the credit reporting agencies to not consider private medical debt.

In evaluating the public credit registry proposal, policymakers should ask as well whether the government is more likely to achieve goals that the private sector is not. The private sector, for example, is already making strides in the use of alternative data to expand credit access. The credit reporting industry is scrutinized on the

accuracy of the data it uses and provides, a valuable third line of defense that would be lost by bringing credit reporting in-house. The U.S. government is in no better place – and, due to the creaking age of its information technology, is in an arguably worse place – to defend the trillions of sensitive data points collected from a data security breach.

Proponents of a public credit registry correctly point out that there are enormous racial disparities in wealth and access to credit. The root causes of these lie at a significantly more fundamental level than credit reporting and are worthy of consideration using the tools best designed to combat these inequities – from financial inclusion programs to assessing local government debt collection and employment practices. As the Demos proposal notes, "we need credit and lending reform as a whole." If this is the case, replacing the private system with a public one with potentially worse outcomes does not seem to be the correct answer. A system of private credit reporting bureaus in competition with each other has fostered innovation, greater access to credit, reduced cost of credit, diversified products, and a stable lending environment relatively immune from political headwinds.

Even if the need for a public credit reporting agency were articulated, would the benefit provided outweigh the cost? The Demos proposal noted that the agency would be housed in the CFPB. It would, of course, be difficult for the agency to be housed anywhere else. As a reference point, take the 1980 Monetary Control Act, which prohibits the Federal Reserve from intervening in a market sector unless "the service is one that other providers alone cannot be expected to provide with reasonable effectiveness, scope, and equity." There is simply no evidence of a market failure that would justify the Fed's intervention – why should the constitutionally-challenged CFPB feel justified? Regardless of where this agency lived, it would cost millions of dollars to create and take years to amass the data required to be useful. The combined private credit rating agencies employ over thirty-five thousand staff. How could the CFPB skill up to that level of manpower and industry expertise? Even if the CFPB could somehow work perfectly to be both participator and regulator in the system, it would still face an obvious conflict of interest, and a government monopoly would discourage competition and innovation.

Conclusions

The business model and services provided by the public credit reporting agencies are not without flaw, and the Biden Administration and Congress could, via legislation and oversight, continue to work to address policy goals including racial inclusion. A public credit reporting agency, in contrast, does not logically or necessarily fix the problems of credit-relevant data collection and credit scoring. Proponents of a public credit reporting agency rely on a single fundamental assumption: that government is better placed than industry to provide competitive services with strong oversight in the most efficient manner to the maximum number of people. Never has this been shown to be the case.