Unplugging the credit-washing machine

Scams to boost scores cause significant losses for banks and consumers alike—and the financial system is ill-equipped to fix it.

BY JASON KRATOVIL

Consumers with poor credit—and even those with good-but-not-great credit that prevents them from getting the luxury-car loan they want—are increasingly resorting to credit-repair products. The sole purpose of many of these products is to game the existing system and paint a false picture of a person's credit risk.

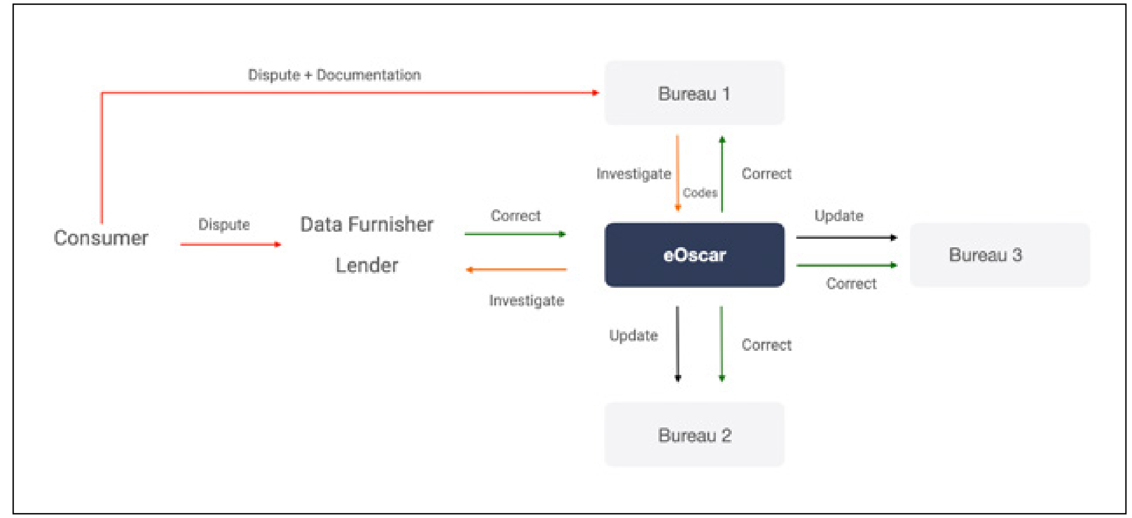
Among these scams is a tactic known as "credit washing." At its core, credit washing is an attempt to hide negative information on a credit report by making a false claim of identity theft. Under the federal Fair Credit Reporting Act, when a person asserts that information on their credit report is the result of identity theft, that information must not be reported until an investigation has been completed.

When the disputed information—usually a negative trade line—is blocked, the person's credit score tends to go up, effectively "washing" their credit history of the unfavorable information.

The dispute process under the FCRA is intended to help legitimate victims struggling through the nightmare of identity theft. However, after the Federal Trade Commission—which oversees the Identity Theft Report form that is integral to the dispute process—removed the requirement for a police report, it opened the floodgates to credit washers. While intended to make the process easier for victims, this change had the unintended consequence of cutting government red tape for fraudsters.

For financial institutions, the challenges are significant. Fundamentally, credit washing distorts a lender's ability to accurately price risk, which makes it very likely that banks will book loans and extend credit to people they otherwise would have turned down. Our data at SentiLink suggests that people who have washed their credit to get a loan are significantly less likely to meet their obligations, leading to higher charge-offs.

In addition, the burden on financial institutions to investigate and resolve every dispute or ID theft claim is significant. Some lenders experience thousands of claims each month, with the vast majority—more than 90%—found to be frivolous. Financial institutions of all sizes are forced to dedicate tremendous resources to managing the flood of bogus disputes and credit-washing attempts.



THE DISPUTE REPORTING PROCESS: CONTRIBUTING TO THE PROBLEM

And adding further to the already difficult situation, midsize and larger financial institutions tend to keep dispute resolution teams (which are compliance-focused) structurally separate from fraud teams. This organizational approach was not a big problem prior to the FTC's decision to no longer require police reports—at that point, the volume of disputes was manageable—but it is now an impediment to any bank interested in connecting dots, spotting patterns and curbing credit-washing losses.

As a result, the financial industry is not well equipped to deal with such scams. For starters, any financial institution can only see what happens on claims of identity theft where it is named on an identity theft report. Put another way, when a bank receives a claim of identity theft from a given consumer, the bank's visibility is limited to only those instances where that consumer has disputed other accounts on the same identity theft report. If, during the prior week, the same consumer successfully disputed trade lines at other institutions, the bank would not have that knowledge. This creates blind spots that make credit washing much easier to commit.

These blind spots are a direct result of a dispute-reporting process designed to check FCRA

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compliance boxes, but not to stop fraud. Disputes come in, notices go out, diligence happens (to varying extents) and decisions are made. What's missing is the sharing of data, trends, insights and patterns that could help the industry get on top of a growing problem and reduce financial losses.

Less discussed are the consequences of credit washing on the FTC's treatment of identity-theft victims. Real victims trying to exercise their rights under the FCRA are often forced to wait at the back of the line behind thousands of bogus claims, which makes it harder for them to get the legitimate assistance they need.

Further, according to the Identity Theft Resource Center, consumers often encounter conflicting requirements imposed by creditors that continue to demand police reports and may not recognize the FTC's identity theft report as a valid document. Compounding this are reports of local law enforcement refusing to provide consumers with a police report for a claim of identity theft. This inconsistency presents a Catch-22 for victims already struggling with the anxiety of identity theft.

Solving the challenge of credit washing and similar scams is very difficult for a single financial institution acting on its own and constrained by a limited field of view. There are strategies that can address these scams, but without concerted and coordinated efforts among industry participants and policymakers to change the fundamental weaknesses that allow credit washing to flourish, a permanent solution to the problem will remain elusive.

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