# Competitive Conditions in the Mortgage Credit Reporting Industry: A Report by the American Antitrust Institute

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## I. Introduction[1]

The American Antitrust Institute ("AAI") is an independent non-profit research, education, and advocacy organization that supports the laws and institutions of antitrust. Our website is www.antitrustinstitute.org. We believe that consumers rely on competition in the market for services related to the origination of residential mortgages to obtain the best service and lowest cost mortgage financing available.[2]

In particular, competition in the credit reporting industry affects the price and accuracy of credit reports, the opportunities for consumers to correct erroneous or stale information, and, ultimately, the cost of credit over the life of a residential mortgage. The role of credit reporting services and credit scoring has become increasingly important in determining the availability and cost of financing since the emergence of automated mortgage underwriting and risk-based pricing in the late 1990's. The AAI believes that the advent of automated underwriting and risk-based pricing without the concomitant introduction of pro-competitive policies, regulations, or legislation related to credit reporting has had the unintended consequence of creating competitive distortions in the credit reporting industry. The AAI is concerned that a lack of fair competition will inure to the detriment of consumers. Current legislative initiatives, motivated in part by the expiry of the state preemption in the Fair Credit Reporting Act and the need to improve accuracy and deter identity theft, present an ideal opportunity to also address the competitive distortions in the credit reporting industry.

This report begins with a brief overview of the mortgage financing market, followed by a discussion of the structure of the credit reporting industry, including the role of the three credit data repositories and the smaller, independent credit reporting agencies (known as "resellers" under the FCRA). Next, we outline three competitive problems that are threatening the continued existence of the smaller, independent resellers: a)

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[1]The authors, Jonathan L. Rubin and Albert A. Foer, are Research Fellow and President of the American Antitrust Institute, respectively. Rubin, an attorney and economist, specializes in antitrust and trade regulation. Foer, an attorney, has authored articles and testified about the Fair Credit Reporting Act and was CEO of a retail company that operated a credit system.

[2]The AAI is funded by contributions to its general treasury coming from individuals, law firms, foundations, corporations, and associations. Seventy separate contributors have given at least $1,000. A list of such contributors is available upon request. One such contributor has been the National Credit Reporting Association ("NCRA"). In preparing this report, the authors reviewed public documents and interviewed independent mortgage brokers, officials of the NCRA and the Consumer Data Information Association, various credit reporting agencies (resellers), several consumer advocate groups that have monitored the credit reporting industry, and others both inside and outside of government.

a price-squeeze in the wholesale pricing of credit reports and ancillary services, including per trade-line pricing of adjustments for re-scoring;[3] b) contractual line-of-business restrictions on the activities of resellers; and, c) territorial restrictions imposed by contract on resellers affiliated with credit repositories. Finally, we set forth why these competitive distortions may be detrimental to consumers.

## II. The Market Background

Residential mortgage loans are originated both by depository institutions (commercial banks and savings institutions) and non-depository institutions (mortgage bankers, mortgage brokers, and others). Some of these loans involve some form of government sponsorship. For example, The Federal Housing Administration ("FHA"), created in 1934, insures loans made by private lenders to protect the lender from default and foreclosure risk, and the Veterans' Administration ("VA") guarantees loans made by private lenders to U.S. veterans. The vast majority of mortgage loans, however, are not insured or guaranteed by the government.

The value of mortgage loans outstanding in 1996 was $4.86 trillion, a figure that by 2002 had grown to over $8.48 trillion, more than 75% of which represents mortgages on single-family homes. Over 70% of all mortgage loans are sold in the secondary market rather than held in the lenders' portfolios. The secondary market is dominated by government sponsored entities ("GSEs"), *i.e.*, the Federal National Mortgage Association ("FNMA," or "Fannie Mae"), the Federal Home Loan Mortgage Corporation ("FHLMC," or "Freddie Mac"), and the Government National Mortgage Association ("GNMA," or Ginnie Mae). Both FNMA and FHLMC are federally chartered, private corporations whose stock trades on the NYSE. Both purchase single family and multifamily FHA/VA and conventional mortgages. These mortgages are either held in portfolios or sold to investors after being packaged into mortgage-backed securities ("MBSs"). Neither entity can originate mortgage loans. FNMA-issued MSBs and their portfolio account for 23% of the residential mortgage market, while FHLMC-issued MSB's and portfolio loans account for about 16%.

In 1968, Ginnie Mae was established as a government-owned corporation within the

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[3] A "trade-line" is information on a credit report which relates to one specific creditor. "Per trade-line pricing" refers to the repositories' practice of charging for making an expedited adjustment or correction to a single trade-line. "Re-scoring" is the practice of re-calculating a consumer's risk score after one or more trade-lines have been corrected on the repository level. Re-scoring differs from "credit repair," which is a practice engaged in by organizations which are not credit reporting agencies. Credit repair practices in which an attempt is made to erase legitimate derogatory information from a credit report are illegal.

U.S. Department of Housing and Urban Development ("HUD"). GNMA primarily purchases FHA and VA mortgages, and unlike FNMA or FHLIC, guarantees the timely payment of principal and interest on the FHA- and VA-backed MBSs they issue.

Life insurance companies and other large financial entities (*e.g.*, pension funds, state and local governments, and finance companies) also purchase mortgage loans on the secondary market, and account for the balance of the investment in non-portfolio loans.

Mortgage loans purchased by FNMA and FHLMC must conform to strict underwriting standards, taking into account the borrower's credit record, employment outlook, the adequacy of the secured property, and the adequacy of the borrower's income. Principle, interest, taxes, and insurance ("PITI"), for example, must satisfy certain ratios to gross income for conventional loans. The principle concern here is the credit history, which for GSE-conforming loans must be based on risk scores calculated from data from all three of the dominant credit reporting agencies with a national credit information database: Equifax, Inc., Trans Union LLC, and Experian (known as "repositories"). Credit reports incorporating data from all three repositories are sometimes called "tri-merged" reports, or 3-bureau reports. Before the advent of automated underwriting, some mortgage lenders discovered that additional credit information was often uncovered when credit reports from all three repositories were analyzed. In 1996, when FNMA and FHLMC updated their underwriting guidelines to accommodate automated underwriting, the requirement for tri-merged reports was adopted. The requirement for tri-merged reports gives each of the repositories a "veto-monopoly" in the wholesale market for credit reports for mortgage lending, *i.e.*, market power based on the necessity that resellers of credit reports for the underwriting of conforming mortgage loans must have access to data from all three repositories.

Each GSE has established a proprietary automated underwriting system. FNMA's system is known as the MORNETPlus® Network, and includes components known as the Desktop Originator® and Desktop Underwriter® ("DO/DU"). FHLMC's automated systems are known as Gold Works® and Loan Prospector® ("LP"). While both GSEs require tri-merged reports, their procedures for obtaining them differ. FNMA has established a network of 13 "sponsors," 12 credit reporting agencies and one trade association (the National Credit Reporting Association, or "NCRA") which provide access and interface to the DO/DU system to approximately 208 downstream credit reporting agencies. The lender-customers of these agencies obtain loan approvals through their automated system in part based on the tri-merged credit reports. By contrast, the FHLMC obtains credit reports from each of the three repositories directly, and involves resellers only when correction, updating, or re-scoring is required. Access to LP is provided through one of five FHLMC credit reporting sponsors which service 100 resellers. HUD employs a "private label" version of DO/DU which is more flexible,

and although they also require tri-merged reports they also continue to accept a 3-bureau version of the pre-automation format known as the Residential Mortgage Credit Report). Because such a large proportion of mortgage loans are purchased by the GSEs, resellers that cannot provide tri-merged reports cannot operate a viable mortgage credit reporting business.

## III. The Structure of the Industry

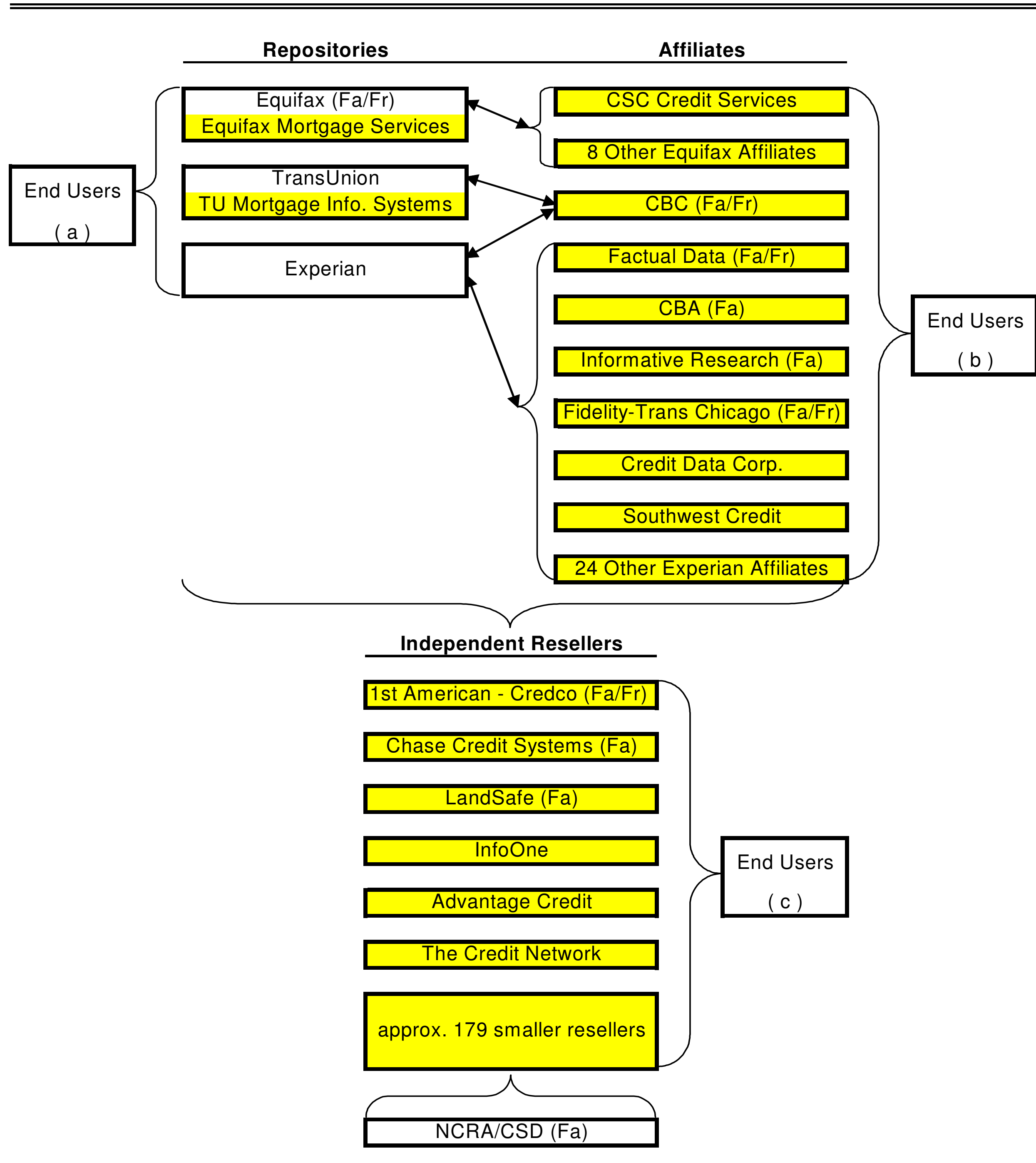
The structure of the credit reporting industry is unique. Ordinarily, an industry dominated by three national firms does not necessarily lead to illegal behavior. In the case of the credit reporting industry, however, because of the tri-merged report requirements, each of the three repositories controls an essential input for the preparation of credit reports for mortgage loan purposes. Thus, each repository possesses market power on the order of a monopoly.

Participants in the industry can be categorized into three groups: Repositories (3), Resellers affiliated with repositories (approximately 40), and Independent resellers (approximately 185). End-users of credit reports purchase from all three segments. This market structure is represented schematically in figure 1.

The shaded areas in figure 1 represent entities or subsidiaries that provide mortgage credit reports to end-users, *i.e.*, mortgage lenders. Equifax and Trans Union each have subsidiaries which provide mortgage credit reports (Equifax Mortgage Services and TU Mortgage Information Systems, respectively), while Experian does not. The "affiliates" act both as resellers and local credit bureaus which administer local databases which compliment the repositories' database. All affiliates sell mortgage credit reports. Over the past several years, the repositories have been aggressively acquiring their affiliates. Trans Union now has a single affiliate which is a large, diversified company operating in five territories (the CBC Companies). Equifax is affiliated with nine companies, including CSC Credit Services, which operates in 52 territories. Experian, which started its affiliate acquisition program last year, has 30 affiliates. Whether directly or through affiliates, each of the three dominant repositories operate at two levels of the credit reporting industry, providing credit reports at "wholesale" to resellers and also at "retail" to end-users.

Independent resellers can be either large or small. The six largest independent resellers are indicated by name on figure 1. The volume of credit reports issued by the larger resellers dwarf those of the smaller resellers. For example, LandSafe, Inc., a subsidiary of Countrywide Financial Corp., issued 4.6 million credit reports during

**Figue 1: Structure of the Credit Reporting Industry**




Fa: Fannie Mae Desktop Originator/Desktop Underwriter (DO/DU) Sponsor
Fr: Freddie Mac Loan Prospector (LP) Sponsor
[yellow box] = Mortgage Credit Report Supplier

2002. By contrast, smaller, local resellers—of which approximately 179 firms remain—do considerably less volume, typically about 150,000 units per year, although some resellers do substantially more. The smaller resellers provide an important benefit for consumers, because they frequently provide enhanced services which verify, update, and correct data that appears on credit reports. For reasons discussed more fully below, the smaller resellers devote a much greater proportion of their resources to providing enhanced services as compared to the repositories or the larger resellers. As a result, the resellers operate in a service-intensive niche market which differs markedly from the market serviced by the larger, more automated organizations.

The current industry structure is the result of three broad trends over the past 5 years, corresponding roughly with the introduction of automated underwriting and risk-based pricing and the 1996 amendments to the FCRA. The first is the tendency of credit bureaus with their own databases to be acquired by the national repository with whom they are affiliated. The second broad trend is the reduction in the ranks of independent resellers. The number of independent resellers in the mortgage credit reporting business, for example, has decreased from over 1,500 to approximately 220 today (mostly smaller resellers and a number of affiliates). Finally, there is a tendency for mortgage lenders or title companies to acquire mortgage credit reporting agencies. In addition to the vertical integration of Countrywide and LandSafe, First American Title Company owns the largest independent reseller, Credco, Fidelity National Financial (acquirer of the former Chicago Title Company) owns Fidelity National Credit Services, an Experian affiliate, and LandAmerica Financial Group, Inc. has recently acquired Info1, the fourth largest independent reseller. All three trends appear to be continuing.

Almost certainly, at least part of the reduction in the number of resellers is due to the tendency of smaller, less efficient competitors to fall by the wayside in an industry experiencing increasing technological sophistication. But smaller resellers were and are facing substantial difficulties caused by anti-competitive conduct on the part of the national repositories. Information gathered from a wide range of sources suggests that the wholesale costs to resellers for credit reports and risk scores, ancillary products (such as the fraud checks required by the GSEs) and re-scoring have increased, while retail prices for the same products offered directly to end-users by the repositories have declined. Similarly, repositories routinely "poach" the resellers' clients and client prospects by offering prices which are at or below wholesale and, thus, impossible for the resellers to match.

Moreover, since the passage of the 1996 amendments to the FCRA—which required resellers to identify the use for which a credit report is requested and the identity of the credit report end-user—the contract terms under which the repositories supply

products to resellers have become increasingly restrictive.[4] Most (but not all) resellers, for example, are prohibited from engaging in the sale of credit reports for any permissible purpose other than mortgage reporting, and tenant and employment screening. Similarly, resellers are prohibited from recovering from consumers, either directly or indirectly through their customers, the costs of re-scoring. In addition, two of the three repositories prohibit their affiliates from competing outside their assigned territories. Understandably, resellers whose future survival depends on continued access to the data controlled by each of the three repositories have been reluctant to complain about such anti-competitive practices, which are presented in more detail in the following section.

## IV. Anti-Competitive Practices and Competitive Distortions

### A. Price Squeezes and Client Poaching

Operating at two levels of distribution means that the repositories and their affiliates are both suppliers to and competitors with the independent resellers. This arrangement by itself does not raise competitive concerns, provided the supplier is not a monopoly. Where the supplier possesses substantial market power, however, it may engage in a price squeeze, *i.e.*, the supplier can raise its wholesale price to the distributor while lowering its retail price to the distributor's customers. Without competing suppliers to turn to, the distributor will be unable to make a "living profit." The classic case establishing that a monopolist's price squeeze can violate Section 2 of the Sherman Act, 15 U.S. C. Sec. 2(a), is *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir., 1945). Other courts in subsequent decisions have reached the same conclusion.[5]

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[4]The Consumer Credit Reporting Reform Act of 1996 dealt with numerous issues not squarely addressed by the FCRA. The reforms permitted bank holding companies, for example, to share transactional information among commonly owned affiliates, gave greater flexibility to credit grantors in handling pre-screened credit offers and allowed consumers to opt-out of such offers, imposed additional duties on furnishers of credit data, and expanded the enforcement powers of the Federal Trade Commission. The reforms also established the 30-day time limit for credit agencies to correct inaccuracies, allowed creditors and insurers to obtain reports to monitor consumer compliance and enumerated other specific permissible uses of credit reports, and imposed privacy protections related to medical information.

[5]This, at least, was Judge (now Justice) Breyer's reading of *Alcoa* in *Town of Concord, Ma. v. Boston Edison Co.*, 915 F.2d 17 (1st Cir., 1990). Less cryptic authority for the illegality of a price squeeze by a supplier with market power may be found in *Bonjorno v. Kaiser Aluminum & Chem. Corp.*, 752 F.2d 802 (3rd Cir., 1984), *cert. denied*, 477 U.S. 908 (1986), *George C. Frey Ready-Mixed Concrete Inc. v. Pine Hill Concrete Mix Corp.*, 554 F.2d 551 (2nd Cir., 1977), and *Carl Hizel & Sons, Inc. v. Browning-Ferris Indus., Inc.,* 600 F.Supp. 161 (D.Colo., 1985).

In the credit reporting industry, the suppliers (repositories) are not monopolists individually, but because of the three-bureau requirement for conforming loans in the GSE's underwriting guidelines, any one repository can "veto" the participation of a reseller in the mortgage credit reporting business, without the necessity of any express or implied agreement or concerted action among the several repositories. Resellers have no alternative but to continue to purchase credit reports from all three repositories regardless of cost. Thus, each monopolist controls an "essential facility" in the market for mortgage credit reports created buy the three-report requirements in the GSEs' underwriting guidelines.

Since about 1996, prices for credit reports sold by the repositories at wholesale to the lower-volume resellers have been steadily rising while at the same time the retail prices the repositories charge directly to end-users with equal or less order volume have been falling. Prices are not published in the credit reporting industry, but when customer loyalty runs high, the resellers are occasionally informed by their customers of the terms of offers such customers have received directly from the repositories or their affiliates, for example:

- A reseller in the Midwest reported that his 2001 price schedule for Trans Union credit reports was:

| Units/Month | Individual | Joint | Credit Score |
|---|---|---|---|
| 0-499 | $2.30 | $4.60 | $0.70 |
| 500-999 | $2.00 | $4.00 | $0.50 |
| 1,000-2,999 | $1.75 | $3.50 | $0.50 |
| 3,000-5,999 | $1.55 | $3.10 | $0.45 |
| 6,000-9,999 | $1.40 | $2.80 | $0.40 |
| 10,000-14,999 | $1.30 | $2.60 | $0.35 |
| 15,000-19,999 | $1.25 | $2.50 | $0.30 |
| 20,000-29,999 | $1.21 | $2.42 | $0.25 |

The reseller's largest customer, however, a local commercial bank, was offered this Trans Union price schedule:

| Units/Month | Individual | Joint | Credit Score |
|---|---|---|---|
| 0-1,499 | $1.60 | $3.20 | $0.40 |
| 1,500-2,499 | $1.35 | $2.70 | $0.40 |
| 2,500 + | $1.10 | $2.20 | $0.40 |

Clearly, because wholesale rates to this reseller exceeded the retail rates Trans Union was willing to accept directly from the reseller's customer for much less volume, the reseller was caught in a price squeeze.

- A California reseller with volume of approximately 70,000 units per month reported that a home-equity lender contacted him with an interest in purchasing 10,000 single-bureau reports per month. The reseller calculated that their wholesale cost for an Equifax report would be $1.75, plus $0.50 for each credit score. Based on a combined cost of $2.25, the reseller offered to sell a report with a credit score to its customer for $2.50, realizing a profit of $0.25 per unit. Equifax, to whom the FCRA requires all end-users to be identified as a condition to obtaining the reports, contacted the reseller's customer directly and offered to sell its reports for $1.90.

- A Florida reseller reported that on a recent visit to an existing customer, his sales representative was given a copy of an invoice for a merged Equifax/Experian credit report, sold directly to the customer by Credit Data Services, Inc., Experian's exclusive affiliate for the State of Florida, for a total cost of $1.50, less than half the reseller's wholesale cost for a 2-bureau report.

- A Massachusetts reseller with an order volume of 3-4,000 units/month reported that his wholesale price for Equifax reports was $1.70, plus $0.35 per credit score. At the same time, Equifax offered to provide a credit report and credit score to one of the reseller's bank customers with monthly order volume of 100-300 units for a combined price of $1.30, and offered tri-merged reports for $13.00, about the same price which the reseller itself must pay at wholesale.

The effect of this type of price squeeze and client poaching on the continued viability of the resellers' business is evident. Resellers are hesitant, however, to complain, fearing that the loss of access to any one repository will destroy their business. Appeals to the repositories are usually rebuffed, and negotiating prices with them is all but impossible. Consider the following plea by a reseller to the Trans Union representative upon learning in 2001 that wholesale prices for various Trans Union products would be increased from between 29 to 250%:

> How can I raise my prices using the above percentage increases to my clients and at the same time maintain their business? My clients have options in our industry, however I do not. What is your motivation in increasing your prices by such a large percentage? Please explain. Is everyone in our industry receiving these price increases? If not, why?

> Most business in the United States is driven by supply and demand and a level playing field. Businesses have choices when they select vendors, except credit reporting agencies. Due to this fact pricing should be uniform to all as there is no competition with respect to the repositories. * * * Is TU following a similar platform to promote fair competition in the credit reporting industry? * * * I respectively ask that TU reconsider the amount of these price increases, as passing on the increases to my clients is not in the best interest of my company.

A similar price squeeze is occurring in the market for tri-merged reports and re-scoring. TU Mortgage Information Systems, the mortgage reporting subsidiary of Trans Union, reportedly offers tri-merged reports directly to mortgage lenders for as little as $5.00, a retail price with which no reseller can compete. The price squeeze is also sometimes carried out by proxy, through the larger resellers with much higher volume than local agencies. These resellers are apparently favored by the repositories, as evidenced by an offer made at a recent conference in the South where Factual Data Corp. was offering tri-merged reports for $7.50.

Repositories justify the disparate treatment of the larger resellers on the basis of volume discounts. But in such an automated industry where the marginal cost of transmitting a credit report is extremely low, such discounts are not likely to be proportional to any volume-related cost savings. Moreover, the volume discounts are much thinner to resellers than they are to end-users. For example, a recent monthly invoice for 18 reports ordered from Equifax by a property manager in the Rocky Mountain region reveals charges of only $2.20, compared to prices charged resellers in that locality that are at or above that level for much higher volumes.

Wholesale prices from the repositories for re-scoring have also increased dramatically, from a level of $5.00-$7.00 per trade line in 2000, to $15.00-$30.00 per trade line today.[6] Meanwhile, Trans Union and Equifax, through their mortgage reporting subsidiaries, continue to offer mortgage lenders re-scoring fees in the $5.00-$7.00 range.

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[6]Per-trade line prices to resellers were increased to these levels by Trans Union and Equifax in 2001 within 60 days of one another. While Experian does not as of this writing offer re-scoring services on a corporate level, some Experian affiliates do offer this service with prices in the range of $5.00-$20.00 per trade line. Experian itself is reportedly in the process of devising its pricing policy for offering re-scoring.

B. Line-of-Business Restrictions On Resellers

Prior to the 1996 amendments to the FCRA, resellers were not routinely prohibited from engaging in any line of legitimate business involving the furnishing of credit reports, *i.e.*, in addition to mortgage reporting and tenant and employment screening, resellers could furnish reports for any permissible purpose under the FCRA. Since then, however, all three repositories have prohibited the smaller resellers from furnishing reports to auto dealerships, credit card companies, consumer finance companies, directly to consumers, or for any other permissible purpose that did not involve a real estate transaction, employment, or tenant screening. These prohibitions are expressly recited in the reseller agreements with which resellers are presented on a take-it-or-leave-it basis. In spite of the fact that such provisions foreclose a substantial share of the credit reporting market (from which favored resellers with a larger volume of transactions are not foreclosed), smaller independent resellers have had no choice but to accept these restrictions.

One reseller on the west coast reported that a lessor of automated teller machines (ATMs) had approached him to supply single-bureau credit reports in connection with the vetting of potential lessees. When the request was made to Equifax to permit this line of business, the reseller was simply told that his contract prohibited it. Such restrictions obviously increase the dependence of the smaller resellers on the mortgage reporting segment of the market and intensify the market power enjoyed by repositories vis-a-vis the resellers. These restrictions also expose resellers to the cyclical swings in revenue which accompany volatility in interest rates. In the absence of the restrictions imposed by the repositories, such exposure could be otherwise mitigated through a greater diversity of business activity and clientele. While the Consumer Data Industry Association ("CDIA") encourages its members (which include both independent resellers as well as the repositories and their affiliates) to diversify its lines of business to avoid cyclical economic shocks, most resellers are prohibited by contract from doing so.

Even where a particular line of business is permissible, resellers may still encounter difficulties. For example, re-scoring is a means by which consumers can have erroneous or stale information in their credit files corrected in a matter of days to avoid having a mortgage transaction derailed. Although the FCRA requires corrections of credit file errors to be made within 30 days, the actual elapsed time between discovery of an error and obtaining a new risk score may be even longer. When the origination process has already commenced, a month or more may be too long of a delay to allow the borrower to close the loan on the terms originally offered. Re-scoring is an increasingly popular device to avoid the consequences of rejection by an automated underwriting system on account of erroneous or inaccurate information in the credit file that has lowered the

borrower's risk score.

Although re-scoring services have proven popular with lenders and borrowers, and resellers routinely offer them, all of the repositories by contract prohibit resellers from charging the consumer "directly or indirectly" for such services. The Equifax reseller agreement, for example, includes an addendum dealing with their "Rapid Resolve" re-scoring service. Under paragraph 4. of the addendum, entitled "Responsibilities of Client and Equifax," the agreement states:

> Client will: * * * (vii) ASSURE THAT ANY COSTS OR FEES EQUIFAX CHARGES CLIENT FOR THE SERVICE WILL UNDER NO CIRCUMSTANCES BE CHARGED BACK TO THE CONSUMER, EITHER DIRECTLY OR INDIRECTLY.

This remarkable provision appears to require either that the reseller absorb the cost of re-scoring, or insist that its customer (*i.e.*, a lender or mortgage broker) do so, since passing on such costs to the borrower clearly involves an "indirect" charge to the consumer.

Not surprisingly, the mortgage brokers—whose customers benefit from the more accurate credit file, higher risk score, and lower mortgage interest rate which often results from re-scoring—resent being told by their credit reporting agency that the fees charged for such services may not be charged to the borrower. The following excerpt is from the March, 2003 issue of the official publication of the National Association of Mortgage Brokers:

> [A]s our NAMB representatives have traveled around the country to teach mortgage brokers and lenders about credit scoring, they consistently heard this complaint: "My credit report company tells me I can't charge a consumer for rapid re-scoring."
>
> Our trainers have spent a great deal of time explaining that the reseller is misinterpreting their contract with the repository. * * * Even though the consumer's information on file at a repository gets modified or updated as a by-product of the re-scoring process, this is not the same as credit repair. It seems to me that the fastest way to spoil this wonderful new service by making it look like credit repair would be for repositories to insist that credit resellers

> restrict mortgage brokers and lenders from charging a fee to the consumer for the upgraded credit report.
>
> NAMB's trainers are instructing mortgage brokers and lenders to have the consumer write the check for the upgraded re-scored report directly to the broker's or lender's company or their trust account. *We are also encouraging mortgage professionals to shop around if their current provider of credit reports continues to hold the line on this baseless policy.* National Mortgage Broker, vol. 19, no. 3, March, 2003, p. 24, at 25 [emphasis added].

Resellers, faced with the prospect of audits and termination by the repositories, are understandably reluctant to deviate from the express terms of their contracts. But at the same time, they are loath to be perceived by their customers as "holding the line on a baseless policy" which costs their customers money. The repositories have been asked to clarify the rules, but have so far refused to do so. Thus, while re-scoring is a permissible business for resellers, the repositories have made it difficult or impossible for resellers to profit from it without risking the alienation of its customers.

## C. Territorial Restrictions on Affiliates

Wholesale credit report prices to resellers vary substantially depending on locality. On occasion, resellers become aware of lower prices offered by affiliates of Equifax and Trans Union in more distant localities. These affiliates, however, refuse to sell to resellers outside their own territories. Resellers are told by the affiliates that they are restricted from competing against each other by policies and contracts dictated by the two repositories. Thus, although the terms of affiliate agreements are strictly confidential, the two repositories appear to have imposed territorial allocations on their affiliates.

Such territorial allocations have been treated as Sherman Act Section 1 violations. Whether such conduct should be adjudged under the *per se* or rule of reason standard depends largely on whether it is considered a horizontally- or vertically-imposed restraint. This issue cannot be resolved without further investigation. One pro-competitive justification for vertically-imposed territorial restrictions is to strengthen inter-brand competition. However, this justification does not apply when resellers must in any case purchase all three "brands" of consumer credit information.

D. The Motivation for Anti-Competitive Conduct and the Intent of the Repositories

If the practices described above amount to anti-competitive conduct designed to drive the smaller—but not the larger—resellers out of business, such an intention must serve an economic rationale and confer some commercial advantage on the repositories. As a source of business, it is reasonable to assume that the continued vitality of the reseller community is in the best interests of the repositories. However, the business practices of smaller resellers differ substantially from those of the larger resellers and the affiliates.

According to mortgage brokers and others consulted by AAI, clients of the smaller resellers prefer them to larger credit reporting firms (often in spite of the higher prices that their clients must pay) principally because of the higher level of personal service they provide. Smaller resellers gain a competitive advantage by having a much higher ratio of personnel-to-volume who are available to read, analyze, and explain consumer credit data, and answer incoming telephone inquiries without the use of automated systems. According to knowledgeable industry insiders, the current business model of repositories and larger resellers is based on automation rather than on providing labor-intensive services designed to review and correct credit information and assist consumers. Avoiding labor-intensive services obviates the need to adjust the firm's labor force through boom-and-bust cycles. By contrast, smaller firms can be more nimble by making adjustments that involve fewer personnel with a greater impact on profitability.

However, as consumers become more sophisticated about credit reporting, and the rigidities of automated underwriting continue to fuel the demand for the kinds of hands-on service now provided by smaller resellers, the need for service-intensity is likely to grow (as evidenced, in part, by the move by Experian to follow the other repositories in establishing re-scoring on the corporate level). In other industries, services have been held to constitute a separate market from the underlying product market. There is a compelling case to be made in the mortgage credit reporting industry that the smaller resellers operate in a distinct service-intensive market.

Through anti-competitive conduct designed to drive smaller resellers out of business, repositories would be able to fill the vacuum and control and dominate the credit reporting servicing market. The repositories, therefore, may well be attempting to monopolize the adjacent service market related to their respective databases through price squeezes and other exclusionary means.

The present industry structure also creates tension between existing local resellers and national repositories and between resellers and creditors who furnish credit

information. Such tension does not exist between the larger resellers and the repositories because the former are organized along much the same automation-intensive lines as the latter. The review and analysis by credit professionals which is routine in smaller reporting firms often leads to requests to update and correct the repository database, requiring repositories to devote resources to the servicing of reseller accounts.

Moreover, the services provided by smaller resellers also often lead to inquiries, requests, and other contacts with the creditors who furnish credit information in the first instance which are intended to obtain more accurate information or update stale or erroneous data. Unfortunately, large creditors which furnish data to the repositories—*e.g.*, national credit card issuers, automobile manufacturers, and national department stores— are especially reluctant to engage with smaller resellers. At least one national credit card issuer flatly refuses to accept inquiries from smaller credit reporting agencies. The single largest concern of the repositories is to maintain the in-flow of credit data, so it is to be expected that they would be protective of large credit furnishers. Thus, smaller resellers engaged in updating and correcting errors created by reporting creditors are often viewed as a liability by the repositories.

Smaller resellers are also a liability to repositories in another sense. With their primary emphasis on customer service, smaller resellers often shed light on repository practices and the extent of their compliance with laws and regulations. They expose inaccuracies and errors in credit data and also educate the public about the industry and about the legal rights of consumers.

Ironically, the service-intensive approach to credit reporting which characterizes most smaller resellers may have been stimulated in part by the higher prices they must charge to earn a profit. Mortgage brokers and bankers who continue to pass on to their clients the cost of higher priced local agencies expect a higher level of service than might be available elsewhere, an expectation that must be fulfilled if local agencies are to retain their clientele and deter them from defecting to larger, less expensive competitors. In light of the growing niche market for credit report services, this fortuitous development has led the smaller resellers to be the first in the industry to meet this demand. Thus, even if the pricing distortions are corrected, it is not likely that resellers will abandon the level of service which has proven to be to their competitive advantage.

## V. The Impact on Consumers if Smaller Resellers Disappear

It is reasonable to ask whether the existence of smaller, independent resellers has a positive impact on consumer welfare, or, conversely, whether their disappearance will

have any appreciable negative consumer welfare consequences. While a comprehensive analysis of this issue is beyond the scope of this report, it is reasonable to conclude that consumers benefit from the presence of smaller resellers both because of the competitive pressures they exert, primarily by setting a high level of consumer service, and for many of the same reasons that the repositories may want to eliminate them.

The inability of smaller resellers to compete on price is made up for by competition on service. Thus, local credit agencies "raise the bar" on the level of services that can be expected not only from larger resellers, but from affiliates and repositories as well. By one estimate, only 25% of mortgage originations involve local credit agencies. Thus, the smaller resellers are a "maverick element" in an industry dominated by large firms.[7] Such maverick elements have exerted disproportional competitive pressures in other industries (*e.g.*, the airline industry, where smaller regional carriers have exerted immense competitive pressures on larger, well-established competitors). As consumer awareness grows, larger firms may feel the need to emulate the level of service provided by smaller agencies and to adjust their business models to accommodate modes of business which rely less on automation and more on expert personnel. Moreover, market pressures may cause a greater percentage of consumers and end-users to migrate to smaller resellers over time. The Federal Trade Commission has met with only limited success in correcting repository practices such as "call blocking" and "call holding," as evidenced by the repeated need to bring administrative actions for violations related to such conduct.[8] Competition from resellers along the service vector may well succeed where regulatory oversight has failed.

Consumers may also benefit from many of the same activities that repositories view as liabilities. Continued pressure on credit grantors may encourage more accurate reporting of data and education of the public may lead to a more responsive industry overall.

## VI. Conclusion and Recommendations

Consumers have a strong interest in maintaining a high level of hands-on service within the mortgage credit reporting industry, so that those involved in the

[7]See Jonathan B. Baker, "Mavericks, Mergers and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws," 77 N.Y.U.L.Rev. 135 (2002).

[8]"Call blocking" is the practice of preventing incoming calls from connecting to a firm's call service center. "Call holding" is placing an incoming call on hold for an inordinate period of time. The FTC requires that repositories limit these practices to certain minimums, and enforces its rules through the filing of administrative complaints.

development and reporting of credit scores will have adequate incentives to assure the currency and correctness of information. For this to occur within a context of automated systems, it is necessary that there be a flourishing independent reseller sector that has a culture tied to hands-on labor intensive service. This sector, with its 'maverick' impact on the rest of the industry, is rapidly disappearing, in part as a result of a variety of anti-competitive activities by repositories with monopolistic market power. This market power could be attacked directly by eliminating the three-report rule, but there appears to be strong opposition based on a fear, not necessarily substantiated, that the result would be incomplete information.

Additionally, the vertical integration of mortgage lenders or title companies and mortgage credit reporting agencies would appear to create incentives which may compromise the accuracy and level of services offered by such agencies, and such arrangements deserve further scrutiny. It is possible that remedies short of vertical divestiture will prove inadequate. While we are not prepared to endorse such a solution at this time, we believe that maintaining the independence of mortgage credit reporting is so important that serious attention should be devoted to the question of whether the increasing levels of vertical integration in the industry represent a threat to consumers that can only be remedied by prohibiting further vertical integration or substantial structural changes.

In the near term, the AAI recommends that the current legislative activity surrounding the FCRA should encompass the following types of reforms designed to assure that independent resellers can compete on a level playing field. First, because the Robinson-Patman Act may not apply, legislation should preclude the type of price discrimination that results in the price squeeze we have described.[9] This should be crafted specifically to prohibit the repositories from setting prices other than on the basis of volume, where the volume discounts are related to cost savings associated with volume, so that the repositories themselves and their friends in the industry will not be able to set retail prices that are lower than the resellers' costs. Second, restrictions by the repositories on lawful activities by the resellers should be eliminated and all resellers should be subject to the same requirements. And third, the right of resellers to charge consumers a reasonable fee for re-scoring services should be clarified. Most importantly, Congress should recognize the consumer interest in not allowing the independent sector of reselling to be destroyed by the policies and tactics of the repositories.

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[9]Section 2(a) of the Robinson-Patman Act, 15 U.S.C. Sec. 13(a), applies only to sales of commodities. At least one federal district court has ruled that the Act does not apply to sales of credit reports because "service predominates over goods in credit report sales." *National Information Services, Inc. v. TRW, Inc.*, 1991 U.S. Dist. LEXIS 21608 (D.Ore., CV No. 90-863-PA, December 17, 1991).