

Making Credit Scores Even More Useless

December 12, 2011 - Credit scoring doesn't work. We've been saying this for years. But as bad as credit scoring is, at least it has been largely an equal opportunity provider of uselessness. By this, I mean that individuals are just as likely to have their credit score inflated for some asinine reason as they are to have it deflated for another asinine reason. But now, there is a proposed bill being considered in Congress that could throw the entire useless credit scoring model on its head by excluding information on foreclosures.

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Credit scores are not generated by people. They are generated by computer algorithms. And those algorithms all lack common sense or the ability to engage in critical thinking. That's a big problem when you consider that 72% of all credit reports contain errors. But if the Fairness in Foreclosure Act passes, the number of inaccurate credit reports will only get worse, and the reasons for this will be codified into federal law. The law is being proposed by Rep. Ed Town (D-NY).

The act would do a number of things that would be detrimental to virtually everyone. In fact, there is something in it to hate for individuals, the credit reporting industry, lenders, credit card companies, and employers alike.

First it would usurp state laws regarding deficiency judgments on foreclosed properties. It is the states, and not the federal government, which currently set the statute of limitations for lenders to sue borrowers when they lose money in a foreclosure. Some states forbid deficiency judgments; either in whole or in part. Others set the limitation for filing law suits to as little as six months or as much as six years after a foreclosure takes place. The proposed law would cap that period to 12 months nationally except in states with shorter statutes of limitation.

The law would also strictly limit deficiency judgments against low income families.

While all of this may sound great to some, the law makes no exceptions for people who lied to get their loans or engages in other forms of mortgage fraud. More importantly, we've seen what happens to the country's financial system when the federal government usurps state laws. That is precisely what happened in the years that led to the current financial crisis. We have no reason to believe that this proposal would work out any better.

The most disturbing thing about the so called Fairness in Foreclosure Act is that if a property is foreclosed on, and the amount the lender is able to recover through the sale of the property doesn't cover the entire loan, then the lender would be forbidden from reporting the amount of the deficiency to credit reporting agencies. The consequences of this could be very bad for borrowers because it would take an already questionable system for determining loan eligibility and make it 100% unreliable. And it would do that for everyone.

Just think about this. Banks would no longer be able to look at credit reports and tell if you paid your bills on time or in full. I'm not just talking about the credit scores here but the actual written credit report would become useless for determining credit worthiness. Likewise for credit card companies. The end result is that in order to cover the additional risk, credit will become even more difficult to get and interest rates will rise for everyone. This is a completely foreseeable consequence.

Employers would no longer be able to rely on credit reports. While that may not be an issue for some positions, it will create big issues for anyone applying for a position in which they work with cash, book keeping, or company finances. The law could make it much more difficult for job applicants to find a job in this type of field. And these things are just the tip of the iceberg.

The reason that credit scoring doesn't work is that you can't capture the essence of who a person is, how responsible they are, how ethical they are, by simply reviewing cursory data on them and running it through a computer algorithm to come up with a number. That's precisely what credit scoring does. But we can say with certainty that ignoring derogatory data in the name of "fairness" will only make the current system completely dysfunctional for everyone. As bad as credit scoring is, this proposed law is not the solution.

byJim Malmberg

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