



Information Policy Institute

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Identity fraud is a significant problem.¹ Estimates of the magnitude of ID fraud differ dramatically, ranging from 44 million per year according to Privacy and American Business, to 160,000 in 2004 according to the National Retail Federation.² The differences are largely explained by definitions of ID fraud, namely whether credit card fraud—by far the largest single form of credit-related fraud—is included in the definition.³

The estimates of its magnitude notwithstanding, ID fraud imposes palpable costs on victims, lenders, and merchants alike. The stakes for the economy are higher still. Former Commerce Secretary Donald Evans recently remarked, “If Americans lose confidence in their credit cards or the Internet, the impact on the economy will be devastating.”

A rational and uniform national law overriding all current laws and establishing a single standard by which consumers exercise a right to a credit file freeze can help to combat identity fraud. By “rational”, we mean a law that possesses the following elements:

- ♦ Verified victims of identity fraud should be able to freeze and unfreeze their credit reports for free, at their discretion, for seven years;
- ♦ Everyone with a credit report should be afforded the opportunity to have their file frozen, but must pay a reasonable fee to have their account frozen and unfrozen; and,
- ♦ Credit bureaus must be given sufficient time to develop the appropriate systems architecture to implement an efficient file freezing regime.

By freezing their credit file, an individual effectively denies access to the contents of their credit report. Thus, when a lender attempts to pull that person’s credit report in response to an application for credit, the credit bureau will advise the lender that the account is frozen. Many file freeze laws today allow lenders to treat applications in which the file is frozen as incomplete.

¹ Identity theft and identity fraud are synonymous for purposes of this paper. Given that most of what is currently defined as identity theft does not involve actual attempts to use an individual’s identity to open new credit accounts or assume other privileges (e.g. employment), but instead involves fraudulent access to another’s credit accounts, identity fraud is a superior descriptive.

² There are good reasons to believe that the numbers reported in the press are sensational estimates, and that the actual incidence of identity theft tends toward the more conservative end of the continuum; a 2003 ID Analytics survey suggests that 7 of 8 cases of ID theft are misidentified as unpaid bills.

³ Congress defines identity theft in the “Identity Theft and Assumption Deterrence Act of 1998” to include credit card fraud. It is for this reason that the Federal Trade Commission includes credit card fraud in its annual tally of identity theft complaints—which declined between 2003 and 2004 from over 10 million to about 9.3 million. The FTC estimates that over half of the total complaints involve credit card fraud.

Ideally, an efficient credit freeze law benefits individuals, credit bureaus, and lenders. Individuals would benefit from an additional protection against identity fraud. Bureaus would benefit from reduced inaccuracies in credit files resulting from fraudulent activity. And lenders would benefit from diminished fraud costs.

A system for freezing credit files is unlikely to be efficient immediately. Credit bureaus will need time to adjust their business operations and IT systems to accommodate a national file freeze framework, and it may take years to resolve some of the less readily apparent problems. As a result, the benefits listed above are not likely to be fully realized in the near term. Moreover, the extent to which file freezes are used will also depend on the presence of other measures; for example, credit monitoring alerts that notify a consumer each time an account is opened in their name may reduce the demand for freezes. Despite these factors, the ultimate total benefits—immediate and over time—in this instance can reasonably be expected to exceed the anticipated implementation costs. These costs, as well as other near term difficulties and potential solutions, are nonetheless worth keeping in mind when crafting a file freeze law. Two are commonly cited:

- ◆ **File freezes can hamper the practice of instant credit**—opponents of credit file freeze legislation have argued that consumers will lose out on discounts on purchases by not being able to apply for store cards, or will lose out on a chance to buy a home because they cannot access their credit immediately and may have to wait days, during which other buyers may secure the deal.

Individual credit files can be unfrozen to enable general access for a period of time, or can be unfrozen for a specific party with a permissible purpose—a home mortgage lender or an auto dealer helping an individual finance a new car. Unfreezing for a period of time is far more common, since individuals often do not know the name or names of the entities of whom they wish to authorize access.

Because of existing systems architecture, the unfreeze process may take as long as two or three days to effect. The length of time it takes to unfreeze a credit file is largely contingent on the fact that the supporting systems are typically not available 24 hours a day seven days a week. There are downtimes at night, on weekends, and during holidays for instance. As a result, any law dealing with credit file freezing should not dictate performance standards for file freezing and unfreezing but rather set a reasonable time limit as has been done in the Fair Credit Reporting Act. In addition, specific technologies for freezing and unfreezing a credit file should not be codified, as viable alternatives may emerge over time.

However, we can reasonably anticipate, to the extent consumer demand for file freezing grows, that the credit bureaus will find ways to reduce the time needed for unfreezing, while continuing to ensure the proper identification of the individual. Over time, consumers will learn to plan for these purchases either through experience or education.

Finally, despite concerns about lost potential sales, the evidence to date suggests that these predictions have not been born out or, at most, have been negligible. In California, the nation's largest state and home of the first credit file freeze law, as of March 2005 fewer than 2,000 people have opted to have their credit files frozen. Of course these numbers are sensitive to the time and effort associated with freezing a credit file, and could be expected to rise should less cumbersome methods become available. (The California standard requires a mailed request.) For instance, should individuals be able to freeze their credit files through the Internet or telephone, the percentage of ID fraud victims who elect to freeze their files could increase significantly.

- ◆ **Preventing file freezing from becoming a fraud platform**—opponents of credit file freeze legislation argue that identity thieves and fraudsters would freeze and unfreeze the files of those persons whose identities they've taken over, and in this way use the consumer protection tool to elude detection.

In that ID thieves are typically detected either by their victims or by lenders monitoring account activity, the enactment of a rational federal file freeze law is not likely to directly impact either of these two detection mechanisms. Individuals with frozen files will still be able to access their credit reports using their PIN or whichever access and verification system emerges, and lenders will still be able to view the same transaction data as before. The alarmist scenario of an identity thief taking over someone's identity so thoroughly as to control their entire account line and credit history is unlikely. Further, it is important that a rational federal standard provide a fraud prevention and identity authentication exemption for frozen files. That is, even though an individual chooses to freeze his or her file, that person's identifying information, as contained in the frozen file, must still be available for fraud prevention and identity authentication purposes—for the individual's own protection.

The Need for a Uniform Federal Standard: Restoring Order to Emerging Chaos

The issue of file freezes has already been decided in the states. California was the first mover, enacting file freeze legislation in October 2001. Recognizing the complexities associated with implementing the new law, a window of 21 months was granted before the law took effect on July 2003. Since then, the proverbial patchwork of differing laws has emerged. Nine other states—Texas, Louisiana, Vermont, Colorado, Connecticut, Illinois, Maine, Nevada and Washington—have enacted file freeze laws, and more are expected to enact similar laws in the coming months and into 2006.

While these state laws share the same objective—to protect against ID fraud—*the scope of the protection afforded and the implementation mechanisms vary wildly*. In some states (Illinois, Texas, Vermont, Washington), only actual victims of ID fraud are able to have their credit files frozen. In other states (California, Colorado, Connecticut, Louisiana, Maine, Nevada) all citizens have the right to freeze their credit reports, while in Washington state, ID fraud victims and those who have received a data breach notification are eligible to have their credit file frozen.

File Freeze Fee Structure: State laws also vary along another significant dimension—the fee structure for freezing and unfreezing a credit file. Basically, only Texas would charge a fee for ID fraud victims to have their credit file frozen, and a freeze issued at one bureau must be honored by all three bureaus keeping the cost to the victim nominal (\$8). In all other states, ID fraud victims may freeze their credit files at no cost. For those who aren't ID fraud victims but wish to freeze their credit file nonetheless, the fee for freezing a credit file ranges between \$8 and \$15 for an indefinite freeze. In the state of Washington, the first freeze is free, but subsequent freezes will cost an individual \$10 per freeze thereafter.

The fee structure for unfreezing credit files is a little more complicated than the file freeze fee schedule. In those states that grant the right to freeze a credit file only to ID fraud victims (IL, TX, VT, WA), there is no fee to unfreeze a credit file. However, in all other states, both ID fraud victims and anyone else with a frozen file must pay between \$8 and \$20 to have their credit file unfrozen.⁴

A rational federal law must address the fee structure issue. There is little debate about this fact. Even some consumer advocates recognize this, as Chris Hoofnagle of Electronic Privacy Information Center was recently quoted as saying, "The thing that is worth paying for is the security freeze."⁵ Clearly, there are costs associated with freezing and unfreezing a credit file. Furthermore, after a credit file has been frozen, credit bureaus are required to maintain those accounts by updating the credit file with information reported on existing accounts. File maintenance costs are typically offset by selling credit files to those entities with an FCRA defined permissible purpose. Credit files that have been frozen cannot be sold. As such, a reasonable file freeze fee structure must take into account the scope of the costs associated with freezing a file—both for the service of the credit file freeze and for the service of account maintenance.

⁴ Generally, individuals are afforded a choice between a temporary unfreezing (usually 30 days) and a one-time unfreezing for a single creditor. The rationale here is that an individual can execute a temporary unfreezing of his/her file, and use the 30 day period to secure financing for a home or auto loan, or shop around for the best credit offers, and then have their file re-frozen to minimize their exposure to risk. The single creditor option gives an individual who has already identified a prospective creditor an opportunity to maximize their protection and apply for credit simultaneously.

⁵ Regnier, Pat and Amanda Gengler. "Are you terrified about identity theft yet? If not, consider this: It could get you killed," *Money*. September 1, 2005.

Credit bureaus should be able to recover those costs—to legislate that these services be provided to all at no cost would be nothing short of legislative takings. But who should be charged and how much should the credit bureaus be able to charge? Victims of ID fraud—those with a police report or a valid ID theft report pursuant to the FACT Act—should not be expected to pay for this service.⁶ By contrast, those individuals who are not ID fraud victims but who elect to have their credit file frozen nonetheless, should be expected to compensate a credit bureau for this service.

Credit File Freeze Life Span and Fee Exemption: State laws in place to date do not place a moratorium on a credit file freeze for ID fraud victims and others choosing to freeze their credit files. A freeze is for life, or until such time as an individual decides to unfreeze their file. There are also no limits placed on the ability of an ID fraud victim to unfreeze their file. In theory, then, an ID fraud victim could freeze and unfreeze their credit file endlessly at no cost.

While ID fraud victims should be afforded privileged status, it is not clear that this privileged status should be for life. A more equitable solution may be to grant an ID fraud victim an exemption from fees for freezing and unfreezing their file for a period of seven years after the most recent fraudulent incident. If fraudulent activity occurs subsequent to placing a freeze on a credit file, the freeze will be extended to cover seven years from that point in time. In this manner, most potential blemishes from fraudulent activity should have been expunged from an individual's credit file before their fee waiver expires. Similarly, individuals who aren't ID fraud victims, but who select to have their credit files frozen nonetheless, would enjoy the same benefits from a seven year freeze cycle.

National Markets Need Uniform National Laws: Given the national structure of our credit system and credit reporting system, laws governing the ability of individuals to control who may access and make use of their credit file must be uniform nationally.

With as many as 15 to 20 separate state credit file laws possible by the close of 2005, Congress must act soon to ensure uniformity. This means that the law enacted by Congress must immediately supercede relevant existing state laws, even during the recommended implementation period. However, Congress must balance the need to act in a timely fashion with the equally compelling need to enact rational legislation permitting the gradual implementation of an efficient national credit file freeze regime by the national credit bureaus. Such a law must include the following elements:

- ◆ An exemption for ID fraud victims from fees for freezing or unfreezing their credit files;
- ◆ A reasonable fee for freezing and unfreezing credit files for all non-victims based on the costs that would be incurred by the CRAs;
- ◆ An 18 to 24 month window for implementing an efficient file freezing regime;

⁶ Fair and Accurate Credit Transactions Act of 2003. Pub. L. 108-159, 117 Stat 152. ("FACT Act"). §112, §151, §152, §153.

- ◆ A 7 year moratorium on a credit freeze fee exemptions from the initial freeze or the date of the most recent fraudulent activity; and,
- ◆ A 7 year moratorium on credit file freezes for non-victims of ID fraud.

A well thought out national and strongly preemptive file freeze law which contains these elements is most likely to well-protect consumers while helping to maintain the strength and efficiency of the US credit system.