

Court Ruling: Credit Bureaus Must Revamp Their Bankruptcy Reporting

By Sonya Smith-Valentine

Millions of consumers who filed for bankruptcy are about to get a second chance at a fresh start.

A recent federal court order required the three major credit reporting bureaus to clean up the credit files of millions of consumers who have filed for Chapter 7 bankruptcy. The problem: old debts that were discharged by the courts in a bankruptcy filing are still being reported as active on many consumers' credit reports. The court-mandated changes come at a time when more consumers are filing for bankruptcy amid rising loan defaults and tighter credit standards.

This ruling is expected to clean up the credit files – and potentially boost the credit scores – of an estimated 6 to 10 million people who filed for Chapter 7 bankruptcy but still had errors in their credit report files. Consumers with old debt are likely to get some relief if those debts were discharged under Chapter 7 protection.

Current reporting systems aren't as accurate as they should be and errors in credit reports are common. Credit report inaccuracies can result in lower credit scores, credit denials and higher interest rates. In many cases, old discharged debts linger on credit reports if lenders don't update their records or if collection agencies ignore the fact that debts were discharged in bankruptcy. Also, some creditors or buyers of debt will not report the bankruptcy discharge to the credit bureaus and will instead "park the debt" during the bankruptcy and then try to collect the debt after it has been legally discharged. The new court-mandated procedures should ensure that anyone who files for bankruptcy in the future will have more accurate credit reports.

The court order stems from a class action lawsuit alleging that each of the credit bureaus violated the Fair Credit Reporting Act by failing to maintain reasonable procedures to assure the accurate reporting of debts that were discharged in bankruptcy. The lawsuit could now move to a trial to determine liability and damages if the court decides to give the case a class action status.

The ruling is significant because the credit bureaus will have to make wholesale changes to the way they report key credit information related to bankruptcy filings. It used to be that the credit bureaus would remove/update pre-bankruptcy debts on consumers' credit files only if the creditors updated their accounts. Now, accounts included in a Chapter 7 bankruptcy will be required to show a zero balance. It appears the credit bureaus were showing the "included in bankruptcy" accounts as having balances and, in some cases, showing active history which could keep the account on a credit file for longer than the seven-year limit. A bankruptcy on the credit report is bad, but when there is a bankruptcy and also debts showing up as overdue and not paid — that's a double hit.

Once a consumer has completed the bankruptcy process, they should request a copy of their credit report from all three credit bureaus. The credit report should indicate a zero balance next to all creditors listed in their bankruptcy, unless they re-affirmed the existing debt during the bankruptcy. If their credit report indicates an error, they should send to the credit bureaus a dispute letter with proof the debt was discharged in bankruptcy. If the credit bureau does not correct the error in the credit report and the consumer then suffers some harm, the consumer can file a lawsuit for damages for violations of the Fair Credit Reporting Act.

Sonya Smith-Valentine is a member of the Valentine Legal Group, LLC. She concentrates her practice on personal finance litigation: credit reporting errors, debt collection disputes and banking problems.