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One Free Yearly Credit Score

By Anne Kim, Tess Stovall, and Ryan McConaghy

The one number that can make or break your financial future isn't your salary—it's your credit score. Good credit scores mean better interest rates on mortgages, bank loans and credit cards, smaller deposits for rent or utilities and even lower insurance premiums. But as important as credit scores are, they're still a mystery to most Americans. Giving consumers access to one free credit score per year can help to make the black box of credit scores more transparent.

THE PROBLEM

Credit scores – what people don't know can hurt them

People with poor or mediocre credit scores pay for them with higher interest rates, bigger security deposits and higher insurance premiums. One study estimates that a 30-point average increase in credit scores would save consumers as much as \$28 billion a year in lower credit card costs alone.¹ Yet for most Americans keeping track of and monitoring their credit scores is difficult and expensive, in part because gaining access to information about consumers' credit scores isn't nearly as easy as it should be.

Credit scores matter.

In general, credit scores have been a boon for consumers. By providing an objective measure of a person's creditworthiness based on past financial history, credit scores have helped lending decisions become faster, fairer and more consistent and have helped eliminate illegal discrimination based on factors such as race. But as the chart below shows, the difference between an excellent, mediocre or bad credit score can cost a consumer more than \$35,000 in additional interest over 30 years on a \$100,000 mortgage. Even when obtaining a loan for a car, a staple of the middle class family, a bad credit score can lead to consumers paying more than triple the amount in interest than they would pay with an excellent credit score.²

Impact of Credit Score on a 30-Year Fixed-Rate Loan for \$100,000³

FICO score	Annual Interest Rate	Monthly Payment	Total Interest Paid	Additional Interest Paid Over Life of Loan
760-850	4.564%	\$510	\$83,778	—
700-759	4.786%	\$524	\$88,575	\$4,797
680-699	4.963%	\$535	\$92,443	\$8,664
660-679	5.177%	\$548	\$97,169	\$13,390
640-659	5.607%	\$575	\$106,827	\$23,049
620-639	6.153%	\$609	\$119,392	\$35,614

Credit scores are available—but only at a price.

Credit scores are available only for a fee, which can range from \$7.95 for a basic score to upwards of about \$180 a year for “credit-monitoring” services that provide periodic updates.⁴ Fewer than half of American adults have obtained their credit score in the past two years,⁵ and one study found that only about half of the people who’ve seen their credit reports have also seen their scores.⁶

Federal law entitles consumers to one free credit report per year from each of the three major credit bureaus that monitor consumer credit information⁷—but this is not the same as the score. These reports include all of the current data on which a credit score would be based but not the credit score itself. For consumers, this is like trying to figure out how well the Yankees are doing based on their individual batting averages, but not their current win-loss record. Moreover, while home mortgage lenders are required to disclose the credit score they used in offering a consumer a loan,⁸ other lenders—such as for auto loans or credit cards—are under no such obligation.

Most consumers know the basics but are far from being experts.

While most Americans understand the fundamentals, such as the importance of paying bills on time, misinformation abounds. Many Americans don’t know, for example, that “maxing out” a credit card can be about as bad as making a late payment.⁹ Many people also wrongly believe their credit scores reflect their income, age, marital status, education or even ethnicity.¹⁰ A large majority of Americans are also unable to define a “good” credit score (700).¹¹ And they don’t know that small changes in behavior could have a large impact on the interest rates that they will pay on loans.

THE SOLUTION

One free yearly credit score

Consumers should have more free access to their credit scores. Their rights should include: (1) for consumers earning less than \$90,000 a year, one free credit score with data from each of the three main credit bureaus per year; and (2) the right to ask any lender or financial institution what credit score it used in a particular transaction. Congress should also provide \$1 million in annual funding to the Federal Trade Commission to conduct a public education campaign on these new consumer rights and disseminate information on how consumers can improve their credit scores.

In order to satisfy the requirement to provide an annual free score, each reporting agency would provide consumers with the score that it most commonly distributes to lenders in connection with applications for mortgage loans.

These proposals would prompt more people to monitor their credit scores.

These proposals are the logical next step in federal law. In fact, 79% of Americans already believe (incorrectly) that they are entitled to one free score per year.¹² The availability of free credit reports has greatly increased the number of people who ask for their reports each year. Prior to the passage of federal law, states that entitled consumers to free credit reports saw request rates that were at least twice as high as in states where no such right existed. In fact, in states where consumers had no access to a free credit report, the request rate was as low as 1.5%.¹³

Knowing the scores used in particular transactions can help consumers better manage their finances.

Consumers don't currently have the right to know which score a lender used in making a loan or financial decision (other than for a home mortgage). But having that information can help consumers in a variety of ways. First, monitoring credit scores will be easier. Credit scores are "dynamic"—they change over time based on new data and the score a person purchased three months ago could be many points off from the score a lender uses to extend a car loan. Knowing the score used for that loan could help a consumer pinpoint problems or provide assurance of being in good shape. Second, consumers can get a broader and more accurate picture of their creditworthiness. Many lenders use their own methods to derive their own version of a credit score, which means that any score purchased by a consumer could be very different from the one that is actually used. Having a variety of different scores can help consumers better understand where they stand in the universe of borrowers.

Moreover, financial institutions would not be required to hand over proprietary information regarding their underwriting standards. Their only obligation would be to disclose the score—not their proprietary models for how that score was derived or how that score is used in making a lending decision.

This proposal builds on existing law.

In 2003, Congress passed the Fair and Accurate Credit Transactions (FACT) Act, which gave customers the right to one free credit report per year. The FACT Act also gave consumers the right to request a credit score from a credit reporting agency, but at a “fair and reasonable” fee. This proposal would simply entitle each consumer to one free credit per score per year while maintaining the existing “fair and reasonable” fee requirement for subsequent credit score disclosures.

The FACT Act also already defines which credit score would be provided. Specifically, the act states that consumer reporting agencies must provide consumers with a score that is widely used in relation to residential property loans or used for consumer education purposes.¹⁴ (Since the FICO score developed by the Fair Isaac Corporation is used in 75% of mortgage originations¹⁵ and is the industry leader,¹⁶ this would mean that consumers would be entitled to one free FICO score per year). Alternatively, credit reporting agencies could be allowed to meet the requirement by providing a commonly distributed, agency-generated score such as the VantageScore, or by offering consumers a choice between their FICO score or a score based on an agency model.

THE ROLLOUT

Ideas for launching and publicizing one free yearly credit score

- **Hold a press conference** with consumers and a non-profit organization or financial institution that has advocated for greater financial education.
- **Release a short report** that demonstrates the impact of a lower credit score on the amount of interest a person would pay on a car loan, mortgage or credit card. Include five tips for how to avoid earning a lower score that can cost consumers money.
- **Conduct an informal local survey** of consumers on what they know about credit scores and how they can improve them.

CRITIQUES & RESPONSES

One free yearly credit score

Won't this put credit bureaus out of business?

No. Entitling consumers to one free credit report per year didn't put the credit bureaus out of business. Instead, it created more consumer awareness of their product and in fact may have created demand for more credit-monitoring and other services. Credit data sales to consumers jumped from \$220 million in 2003, the year the FACT Act was signed into law, to \$488 million in 2006 and are expected to exceed \$860 million by 2010.¹⁷ Giving consumers one free credit score per year could have the same effect. It would not replace any of the existing products and could in fact increase demand for credit-monitoring and other products that offer advice to consumers on how their scores could be improved.

Wouldn't this make consumer reporting agencies give away a product that they have to pay for themselves?

Not necessarily. It's true that not all credit scores are solely products generated by the reporting agencies. For example, Fair Isaac Corporation licenses its scoring model to the consumer reporting agencies, which subsequently make royalty payments to Fair Isaac Corporation for use of the model in generating scores they sell to lenders.¹⁸ In the event that a bureau-based score model, such as VantageScore, is disclosed, the score in question would be solely a credit bureau product, much like the credit reports the scores are derived from. Should a score derived from an algorithm from an outside modeler, such as the Fair Isaac Corporation, be provided, the bureaus would likely see increased revenues from subsequent credit monitoring purchases that would more than offset any royalty payment losses.

Why is a free score necessary when buying a score is cheap?

Yes, credit scores can be purchased for as low as \$8—but the payment has become a barrier to consumers. A majority of Americans still are not regularly checking their credit score or their report. Given the importance of this number to people's financial success, it's important to remove as many obstacles as possible and broaden people's access and knowledge of their credit reports and scores.

Wouldn't this burden financial institutions?

Only marginally. These proposals do not create an affirmative obligation on financial institutions to disclose a credit score with every transaction—it only entitles consumers to ask for and obtain the score used in a particular transaction. The burden is wholly on the consumer. For financial institutions, there would be

no additional paperwork and no additional costs associated with generating a new score. The score can even be provided over the phone and not in writing. Moreover, financial institutions would not be required to hand over proprietary information regarding their underwriting standards. Their only obligation would be to disclose the score—not their proprietary models for how that score was derived or how that score is used in making a lending decision.

Isn't picking one score ineffective since multiple scores are used and scores change over time?

No. While it is true that scores are dynamic and the score provided to a consumer upon request may not be the exact score used by lenders at the time credit is approved or denied, allowing consumers access to one free benchmark score will provide potential borrowers with the ability to ascertain whether they have good or bad credit, are likely to face higher interest charges, or need to make financial adjustments before applying for credit.

Isn't it discriminatory to require consumer reporting agencies to provide this information without putting a requirement on score modeling companies like the Fair Isaac Corporation?

No. The FACT Act recognized the need to differentiate between consumer reporting agencies and other actors and established a requirement specifically for the consumer reporting agencies, and not for other entities, to provide a credit score and other information upon request for a fee.¹⁹ This proposal builds on that established precedent and institutes no new division between regulated providers like the consumer reporting agencies and unregulated providers like Fair Isaac Corporation.

Didn't the Federal Trade Commission express concerns that setting a fixed price for credit scores would place regulated sellers (i.e. consumer reporting agencies) at a competitive disadvantage, and that setting the fee too low would cause sellers to cut corners on other services?

In the process of determining what would constitute a “fair and reasonable fee”²⁰ the Federal Trade Commission did express concerns that in a mixed market fixed prices may disadvantage regulated sellers, such as consumer reporting agencies, and that low fees may have negative impacts on other services.²¹ However, these concerns were raised in relation to all credit score disclosures. Under this proposal, consumers would be entitled to only one free credit score per year. All other scores would be governed by existing rules and fair market rates as determined by the Federal Trade Commission.

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■ ENDNOTES

1 News Release, "Consumer Understanding of Credit Scores Improves But Remains Poor," Consumer Federal of America and Washington Mutual, July 10, 2008, available at http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/Credit_Score_PR_7-10-08.pdf.

2 Calculations come from the Loan Savings Calculator, available at <http://www.myfico.com/myfico/CreditCentral/LoanRates.asp>. Calculation based on a 60-month new auto loan for \$28,400, the average price of a new car sold in the U.S. according to the Federal Trade Commission, available at <http://www.ftc.gov/bcp/edu/pubs/consumer/autos/aut11.shtm>.

3 Calculations come from the Loan Savings Calculator, available at <http://www.myfico.com/myfico/CreditCentral/LoanRates.asp>.

4 VantageScore is a generic credit scoring model that was developed jointly by the three main consumer reporting agencies (Equifax, Experian, and TransUnion). More information is available at <http://www.vantagescore.com/>. Equifax provides a FICO/Beacon score to consumers for \$7.95, and offers credit monitoring services for \$14.95 per month, see <http://www.equifax.com/creditproduct-list/>. Testimony of Richard G. Goerss, Chief Privacy Officer and Regulatory Counsel, Equifax Inc., U.S. House Financial Services Subcommittee on Oversight and Investigations hearing, "What Borrowers Need to Know About Credit Scoring Models and Credit Scores," July 29, 2008, available at <http://financialservices.house.gov/hearing110/goerss072908.pdf>. TransUnion offers consumers the opportunity to purchase their VantageScore for \$7.95 when they obtain their annual free credit report and credit 3-Bureau monitoring services for \$14.95 per month, see <https://www.truecredit.com/products/optimizedOrder.jsp?versionID=0&package=FreeTrialTriBureauCMU&formName=freeTriBureauCMUChoice&cb=TransUnion&loc=1756>. Testimony of Chet Wiermanski, Group Vice President, Global Analytic and Decision Systems, TransUnion LLC, U.S. House Financial Services Subcommittee on Oversight and Investigations hearing, "What Borrowers Need to Know About Credit Scoring Models and Credit Scores," July 29, 2008, available at <http://financialservices.house.gov/hearing110/wiermanski072908.pdf>. Experian allows consumers to purchase their VantageScore for \$7.95 and offers monitoring services for \$14.95 per month. See <http://www.experian.com/consumer-products/personal-credit.html>.

5 Consumer Federation of America and Washington Mutual.

6 Government Accountability Office, "Credit Reporting Literacy: Consumers Understood the Basics but Could Benefit from Targeted Educational Efforts," March 2005, available at <http://www.gao.gov/new.items/d05223.pdf>.

7 The Fair Credit Reporting Act, as amended, codifies the following rights for consumers, among others: (1) the right to receive one free copy of a credit report annually from each of the three major credit bureaus; (2) the right to know who has requested a consumer's credit report in the past year (or in the past two years for employment purposes); (3) the right to dispute incorrect information on a credit report; and (4) the right to receive a credit report after the denial of a credit application.

8 Fair and Accurate Credit Transactions (FACT) Act of 2003, Public Law 108-159.

9 Consumer Federation of America and Washington Mutual.

10 Ibid.

11 News Release, "National MoneyWi\$e Survey Shows Americans Are Not Financially Fit," Consumer Action and Capital One, September 6, 2005, available at http://www.consumer-action.org/news/articles/national_moneywie_survey_shows_americans_are_not_financially_fit/.

12 Consumer Federation of America and Washington Mutual.

13 Government Accountability Office. In Colorado, where consumers were notified of their right to a free credit report by mail, the request rate was as high as 10-11%.

14 Section 212 of the FACT Act of 2003, Public Law 108-159.

15 FICO, "About Us," available at <http://www.fico.com/en/Company/Pages/about.aspx>.

16 Michelle Singletary, "Consumers Lose in This Love Triangle," Washington Post, February 12, 2009, available at <http://www.washingtonpost.com/wp-dyn/content/article/2009/02/11/AR2009021103621.html>.

17 Byron Acohido and Jon Swartz, "'Free' Credit Reports Sometimes Aren't Free," USA Today, November 28, 2007, available at http://www.usatoday.com/money/perfi/credit/2007-11-27-credit-scores_N.htm.

18 Evan Hendricks, "Credit Scores and Credit Reports: How the System Works and What You Can Do," Privacy Times, May 30, 2004.

19 Section 212 of the FACT Act of 2003, Public Law 108-159, requires that upon request from a consumer, a consumer reporting agency shall supply the current credit score of the consumer or the most recent credit score of the consumer that was previously calculated by the credit reporting agency for a purpose related to the extension of credit as well as other associated information.

20 Section 212 of the FACT Act of 2003, Public Law 108-159, allowed consumer reporting agencies to charge a "fair and reasonable fee" for credit scores as determined by the Federal Trade Commission.

21 Federal Trade Commission, "Fair and Reasonable Fee for Credit Score Disclosure: Advance Notice of Proposed Rulemaking, Request for Comment," Federal Register, Vol. 69, No. 215, p.64698, November 8, 2004, available at http://frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?position=all&page=64698&dbname=2004_register.