

Middle Class Proposal #11

Improving Credit Score Disclosure

The one number that can make or break someone's financial future isn't salary—it's their 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 and the right to more disclosure can make the black box of credit scores transparent.

THE PROBLEM

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

People with poor or mediocre credit scores pay for it—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 and monitoring their credit scores is difficult and expensive—in part because gaining access and 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 such factors as race. But because credit scores are so important, the difference between an excellent, mediocre or bad credit score can cost consumers more than one hundred thousand dollars.

Impact of Credit Score On a 30-Year Fixed-Rate Loan for \$100,000²

FICO score	Annual interest rate	Monthly payment	Total interest paid	Additional interest paid over life of loan
720-850	6.469%	\$630	\$126,811	---
700-719	6.594%	\$638	\$129,775	\$2,963
675-699	7.131%	\$674	\$142,684	\$15,873
620-674	8.281%	\$753	\$171,241	\$44,430
560-619	12.018%	\$1,030	\$270,799	\$143,988
500-559	12.985%	\$1,105	\$297,810	\$170,999

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.³ Many people also wrongly believe their credit scores reflect their income, age, marital status, education or even ethnicity.⁴ A large majority of Americans are also unable to define a "good" credit score (700).⁵ And they don't know that small changes in behavior could have a large impact on the interest rates that they will pay in loans.

Credit scores are available—but only at a price.

"Getting an accurate reading of your credit score remains problematic and costly," according to a recent CNN feature.⁶ Federal law entitles consumers to one free *credit report* per year from each of the three major credit bureaus that monitor consumer credit information.⁷ 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.

Credit scores are available only for a fee, which can range from \$5.95 for a "basic" score to upwards of \$200 a year for "credit-monitoring" services that provide periodic updates.⁹ Fewer than half of American adults have obtained their credit score in the past two years,¹⁰ and one study found that only about half of the people who've seen their credit reports have also seen their score.¹¹

THE SOLUTION

Better rights to credit score disclosure

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 along with their annual free credit report; 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.

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.

THE ROLLOUT

Ideas for launching and publicizing better rights to credit score disclosure

- **Hold a press conference** with consumers and a non-profit organization or financial institution that has advocated 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

Better rights to credit score disclosure

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. 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.

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

Yes, credit scores can be purchased for as low as \$6—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 report 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.

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/pdfs/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>

³ 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/pdfs/Credit_Score_PR_7-10-08.pdf

⁴ Ibid.

⁵ "National Survey Shows Americans Need to Get Financially Fit; Capital One and Consumer Action Find Majority of Americans Lack Basic Understanding of Credit Scores and the Fundamentals of Personal Finance," *Business Wire*, September 6, 2005.

⁶ Jessica Dickler, *CNN Money*, "Settling the Credit Score," August 7, 2008.

⁷The Fair Credit Reporting Act codified 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 Act of 2003, Public Law 108-159.

⁹ See www.myfico.com

¹⁰ 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/pdfs/Credit_Score_PR_7-10-08.pdf

¹¹ 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>

¹² 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/pdfs/Credit_Score_PR_7-10-08.pdf

¹³ 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>. 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%.