Consumer Federation of America

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MILLIONS OF AMERICANS JEOPARDIZED BY INACCURATE CREDIT SCORES

Washington, D.C. – Millions of Americans could pay more for – or be denied – credit, insurance, or utilities because of inaccurate credit scores, according to a new study, *Credit Score Accuracy and Implications for Consumers*, released this morning by the Consumer Federation of America (CFA) and the National Credit Reporting Association (NCRA).

Research for the study, conducted during the summer of 2002, analyzed the credit scores of more than 500,000 consumers, and extensively reviewed the files of more than 1,700 individuals, maintained by the three major credit repositories – Equifax, Experian, and Trans Union. Nearly 200 million Americans have credit files.

The analysis of the scores in 502,623 merged credit files reveals that 29 percent of these consumers had scores with a range of at least 50 points, while four percent of the consumers had score ranges of at least 100 points. The average range of the three scores was 41 points, and the median range was 35 points. Credit scores range from approximately 400 to 800.

"This frequent huge discrepancy in scores reveals the importance of consumers being able to quickly learn and correct inaccuracies," said J. Robert Hunter, CFA's Director of Insurance. "Creditors should be required to provide to consumers, charged anything other than the best available rate or denied credit, a copy of credit reports free of charge, then to reconsider their decision based on any corrections," he added.

The research was conducted with explicit safeguards to protect the privacy and anonymity of all consumers whose credit records were examined. No names, addresses, social security numbers, dates of birth, account numbers or any information that could be used to trace back to a specific consumer were recorded during the research.

What Are Credit Scores?

A credit score is a single number, based on an analysis of information contained in a credit report, that provides an indication of how likely a person is to repay his or her debts. It is based on several types of information, including payment history, amount of debt owed, and types of credit used. Credit scores, and the credit reports on which they are based, increasingly influence consumer access to credit, housing, insurance, basic utility services, and even employment.

The growing use of credit scores has increased the speed with which many credit decisions can be made, the potential for customized pricing of credit, and the overall efficiency of credit granting. However, in consumer lending, inaccurate scores can result in unfair treatment of borrowers who are denied or charged high prices for credit.

Errors of Omission and Commission Found

The analysis of 51 representative files for consistencies and inconsistencies revealed reasons for these differences in scores. Common errors of omission were the failure to report a negative event – for example, a delinquency or charge off – or a positive event – for example, payments on an account. Seventy eight percent of files were missing a revolving account in good standing while one-third (33 percent) of files were missing a mortgage account that had never been late.

More serious errors of commission appeared in a significant portion of files. In 43 percent of the files, reports on the same accounts conflicted in regard to how often consumers had been late by 30 days. In 29 percent of the files, there was conflicting information about how many times the consumer had been 60 days late. And in 24 percent of the files, conflicts existed about 90-day delinquencies. Reported delinquencies have a large effect on credit scores.

"While the sample of 51 is too small to generalize reliably to all credit files, the frequency of errors in these files strongly suggests that errors of omission and commission exist in the credit files of millions of consumers," said Terry W. Clemans, NCRA Executive Director. "Further, these errors or inconsistencies are being factored into decisions made via automated underwriting models and credit scoring systems," he continued.

Mortgage Purchasers Particularly at Risk

The study focuses particular attention on consumer credit risks, especially in the purchase of mortgage loans. It reveals that, for first or second mortgage loan purchasers, a score of 620 is necessary to qualify for prime loan at conventional rates. Consumers with scores below this level are likely to be charged subprime rates or be denied the loans.

CFA and NCRA paid particular attention to at risk consumers, which we defined as those with scores between 575 and 630 where there was at least a 30-point range between low and high credit scores, or whose high and low scores were, respectively, above and below 620. One-fifth of all 1,704 files studied manually met these criteria and were designated as at-risk. We estimate based on reviews of these files that, for these consumers, at least one-fifth would be harmed, and one-fifth would benefit, from score inaccuracy if they tried to purchase mortgage loans.

"Equal numbers of those harmed by and benefiting from inaccurate credit score are not a wash," said Stephen Brobeck, CFA Executive Director. "The allocation of consumer credit should not be a lottery where one has to be lucky to receive fairly priced loans," he added.

Falling below the 620 cutoff point can impose significant costs on mortgage borrowers. Over the life of a 30-year, $150,000 mortgage, for example, a borrower incorrectly charged a subprime rate of 9.84 percent instead of a prime rate of 6.56 percent would pay $317,517 in interest instead of only $193,450 in interest – a difference of $124,067 in interest payments.

Consumers Not Given Useful and Timely Information

Consumers who are informed about the reasons for their credit score are not given useful and timely information. Nearly seventy percent of the 1,704 credit reports examined indicate that the primary factors contributing to the score were "serious delinquency, derogatory public record, or collection filed" or some combination of these factors. Consumers were not provided with information about which specific accounts were responsible for the low scores. And in many cases, it is not even clear – from our inspection of the files – whether a delinquency, public record, or collection was responsible for the score.

The research found that certain information in credit reports has the potential to cause breaches in consumer medical privacy. Many credit report entries regarding medical collections contained enough information to infer medical details about consumers, such as the type of treatment they had received. The ability to discern from a credit report that a consumer may have received treatment from a neonatal clinic, fertility clinic, mental health provider, or AIDS clinic could potentially facilitate discriminatory treatment.

CFA and NCRA Recommend Policy Changes

The extent of inaccuracy in credit files and scores, and their growing importance for consumers as they purchase credit, insurance, and utilities, and seek rental housing and employment, suggests needed policy changes.

First, require creditors to immediately provide consumers who experience adverse actions (i.e., higher rate or no loan), as a result of credit reports or scores, a free copy of the credit reports serving as the basis for the decision and quick reconsideration of the decision if inaccuracies are found.

Second, require creditors who base decisions with adverse actions on the credit report or score from a single repository to re-evaluate the decision using information from all three major repositories.

Third, strengthen requirements for complete and accurate reporting of account information to credit repositories, and maintenance of consumer data by the repositories, with adequate oversight and penalties for non-compliance.

Fourth, appropriate government agencies, such as the U.S. Department of Housing and Urban Development (HUD) and the Federal Trade Commission, should conduct regular, comprehensive evaluations of the validity and fairness of all credit scoring systems (including automated mortgage underwriting systems, insurance underwriting systems, tenant and employee screening systems) and report the findings of these evaluations to Congress.

Consumers can Minimize Adverse Actions

To reduce the chance of adverse actions such as being charged higher prices or being denied credit, consumers can take preventive steps.

First, maintain consistency in credit applications by using your full legal name.

Second, review your credit record regularly by purchasing a credit report and score from each major credit repository once a year, but especially before you apply for a mortgage loan.

Third, dispute any errors that appear on your credit report by contacting the relevant credit repository. The repositories can be contacted at the following phone numbers and website addresses: Equifax (800) 685-1111 or www.equifax.com; Experian (888) EXPERIAN or www.experian.com; Trans Union (800) 888-4213 or www.transunion.com.

Fourth, if a lender tells you that you have bad credit, ask them for specifics. While currently lenders are not required to give you this information, they are permitted to, and many will.

Fifth, if you have complaints about your credit report and are unable to have them quickly resolved, contact the Federal Trade Commission at 1-877-FTC-HELP or www.ftc.gov.

Study and Policy Recommendations to be Widely Distributed

CFA and NCRA will be distributing copies of this report to policy makers and regulators, including key Members of Congress, the Federal Trade Commission, Governors, State Insurance Commissioners, and State Attorneys General.

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CFA is a nonprofit association of 300 pro-consumer organizations that, since 1968, has sought to advance the consumer interest through education and advocacy. The National Credit Reporting Association is a ten-year old national trade organization of consumer reporting agencies and associated professionals that provide products and services to hundreds of thousands of credit grantors, employers, and landlords.