FTC Facts For Consumers

focus on CREDIT

Federal Trade Commission
For The Consumer

www.ftc.gov ■ 1-877-ftc-help

July 2007

Need Credit or Insurance?

Your Credit Score Helps Determine What You'll Pay

Ever wonder how a lender decides whether to grant you credit? For years, creditors have been using credit scoring systems to determine if you'd be a good risk for credit cards, auto loans, and mortgages. These days, many more types of businesses — including insurance companies and phone companies — are using credit scores to decide whether to approve you for a loan or service and on what terms. Auto and homeowners insurance companies are among the businesses that are using credit scores to help decide if you'd be a good risk for insurance. A higher credit score means you are likely less of a risk, and in turn, means you will be more likely to get credit or insurance — or pay less for it.

The Federal Trade Commission (FTC), the nation's consumer protection agency, wants you to know how credit scoring works.

The FTC wants you to know how credit scoring works.

What is credit scoring?

Credit scoring is a system creditors use to help determine whether to give you credit. It also may be used to help decide the terms you are offered or the rate you will pay for the loan.

Information about you and your credit experiences, like your bill-paying history, the number and type of accounts you have, whether you pay your bills by the date they're due, collection actions, outstanding debt, and the age of your accounts, is collected from your credit report. Using a statistical program, creditors compare this information to the loan repayment history of consumers with similar profiles. For example, a credit scoring system awards points for each factor that helps predict who is most likely to repay a debt. A total number of points — a credit score — helps predict how creditworthy you are — how likely it is that you will repay a loan and make the payments when they're due.

Some insurance companies also use credit report information, along with other factors, to help predict your likelihood of filing an insurance claim and the amount of the claim. They may consider these factors when they decide whether to grant you insurance and the amount of the premium they charge. The credit scores insurance companies use sometimes are called "insurance scores" or "credit-based insurance scores."

Credit scores and credit reports

Your credit report is a key part of many credit scoring systems. That's why it is critical to make sure your credit report is accurate. Federal law gives you the right to get a free copy of your credit reports from each of the three national consumer reporting companies once every 12 months.

The Fair Credit Reporting Act (FCRA) also gives you the right to get your credit score from the national consumer reporting companies. They are allowed to charge a reasonable fee, generally around $8, for the score. When you buy your score, often you get information on how you can improve it.

Your credit report is a key part of many credit scoring systems.

To order your free annual report from one or all the national consumer reporting companies, and to purchase your credit score, visit www.annualcreditreport.com, call toll-free 1-877-322-8228, or complete the Annual Credit Report Request Form and mail it to: Annual Credit Report Request Service, P. O. Box 105281, Atlanta, GA 30348-5281. The form is at the back of this brochure; or you can print it from www.ftc.gov/credit. For more information, see *Your Access to Free Credit Reports* at www.ftc.gov/credit.

How is a credit scoring system developed?

To develop a credit scoring system or model, a creditor or insurance company selects a random sample of its customers, or a sample of similar customers, and analyzes it statistically to identify characteristics that relate to risk. Each of the characteristics then is assigned a weight based on how strong a predictor it is of who would be a good risk. Each company may use its own scoring model, different scoring models for different types of credit or insurance, or a generic model developed by a scoring company.

Under the Equal Credit Opportunity Act (ECOA), a creditor's scoring system may not use certain characteristics — for example, race, sex, marital status, national origin, or religion — as factors. The law allows creditors to use age in properly designed scoring systems. But any credit scoring system that includes age must give equal treatment to elderly applicants.

What can I do to improve my score?

Credit scoring systems are complex and vary among creditors or insurance companies and for different types of credit or insurance. If one factor changes, your score may change — but improvement generally depends on how that factor relates to others the system considers. Only the business using the scoring knows what might improve your score under the particular model they use to evaluate your application.

Nevertheless, scoring models usually consider the following types of information in your credit report to help compute your credit score:

- Have you paid your bills on time? You can count on payment history to be a significant factor. If your credit report indicates that you have paid bills late, had an account referred to collections, or declared bankruptcy, it is likely to affect your score negatively.

- Are you maxed out? Many scoring systems evaluate the amount of debt you have compared to your credit limits. If the amount you owe is close to your credit limit, it's likely to have a negative effect on your score.

- How long have you had credit? Generally, scoring systems consider the length of your credit track record. An insufficient credit history may affect your score negatively, but factors like timely payments and low balances can offset that.

- Have you applied for new credit lately? Many scoring systems consider whether you have applied for credit recently by looking at "inquiries" on your credit report. If you have applied for too many new accounts recently, it could have a negative effect on your score. Every inquiry isn't counted: for example, inquiries by creditors who are monitoring your account or looking at credit reports to make "prescreened" credit offers are not considered liabilities.

- How many credit accounts do you have and what kinds of accounts are they? Although it is generally considered a plus to have established credit accounts, too many credit card accounts may have a negative effect on your score. In addition, many scoring systems consider the type of credit accounts you have. For example, under some scoring models, loans from finance companies may have a negative effect on your credit score.

Scoring models may be based on more than the information in your credit report. When you are applying for a mortgage loan, for example, the system may consider the amount of your down payment, your total debt, and your income, among other things.

Improving your score significantly is likely to take some time, but it can be done. To improve your credit score under most systems, focus on paying your bills in a timely way, paying down any outstanding balances, and staying away from new debt.

Are credit scoring systems reliable?

Credit scoring systems enable creditors or insurance companies to evaluate millions of applicants consistently on many different characteristics. To be statistically valid, these systems must be based on a big enough sample. They generally vary among businesses that use them.

Scoring models may be based on more than the information in your credit report.

Properly designed, credit scoring systems generally enable faster, more accurate, and more impartial decisions than individual people can make. And some creditors design their systems so that some applicants — those with scores not high enough to pass easily or low enough to fail absolutely — are referred to a credit manager who decides whether the company or lender will extend credit. Referrals can result in discussion and negotiation between the credit manager and the would-be borrower.

What if I am denied credit or insurance, or don't get the terms I want?

If you are denied credit, the ECOA requires that the creditor give you a notice with the specific reasons your application was rejected or the news that you have the right to learn the reasons if you ask within 60 days. Ask the creditor to be specific: Indefinite and vague reasons for denial are illegal. Acceptable reasons might be "your income was low" or "you haven't been employed long enough." Unacceptable reasons include "you didn't meet our minimum standards" or "you didn't receive enough points on our credit scoring system."

Sometimes you can be denied credit or insurance — or initially be charged a higher premium — because of information in your credit report. In that case, the FCRA requires the creditor or insurance company to give you the name, address, and phone number of the consumer reporting company that supplied the information. Contact the company to find out what your report said. This information is free if you ask for it within 60 days of being turned down for credit or insurance. The consumer reporting company can tell you what's in your report; only the creditor or insurance company can tell you why your application was denied.

If a creditor or insurance company says you were denied credit or insurance because you are too near your credit limits on your credit cards, you may want to reapply after paying down your balances. Because credit scores are based on credit report information, a score often changes when the information in the credit report changes.

If you've been denied credit or insurance or didn't get the rate or terms you want, ask questions:

- Ask the creditor or insurance company if a credit scoring system was used. If it was, ask what characteristics or factors were used in the system, and how you can improve your application.
- If you get the credit or insurance, ask the creditor or insurance company whether you are getting the best rate and terms available. If you're not, ask why.
- If you are denied credit or not offered the best rate available because of inaccuracies in your credit report, be sure to dispute the inaccurate information with the consumer reporting company. To learn more about this right, see *How to Dispute Credit Report Errors* at www.ftc.gov/credit.

The FTC works for the consumer to prevent fraudulent, deceptive and unfair business practices in the marketplace and to provide information to help consumers spot, stop, and avoid them. To file a complaint or to get free information on consumer issues, visit www.ftc.gov or call toll-free, 1-877-FTC-HELP (1-877-382-4357); TTY: 1-866-653-4261. The FTC enters Internet, telemarketing, identity theft, and other fraud-related complaints into Consumer Sentinel , a secure online database available to hundreds of civil and criminal law enforcement agencies in the U.S. and abroad.

EQUIFAX experian TransUnion

Annual Credit Report Request Form

You have the right to get a free copy of your credit file disclosure, commonly called a credit report, once every 12 months, from each of the nationwide consumer credit reporting companies - Equifax, Experian and TransUnion.

For instant access to your free credit report, visit www.annualcreditreport.com.

For more information on obtaining your free credit report, visit www.annualcreditreport.com or call 1-877-322-8228.

Use this form if you prefer to write to request your credit report from any, or all, of the nationwide consumer credit reporting companies. The following information is required to process your request. **Omission of any information may delay your request.**

Once complete, fold (do not staple or tape), place into a #10 envelope, affix required postage and mail to:

Annual Credit Report Request Service P.O. Box 105281 Atlanta, GA 30348-5281.

Please use a Black or Blue Pen and write your responses in PRINTED CAPITAL LETTERS without touching the sides of the boxes like the examples listed below:

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z   0 1 2 3 4 5 6 7 8 9

Social Security Number:

_ _ _ - _ _ - _ _ _ _

Date of Birth:

_ _ / _ _ / _ _ _ _

Month Day Year

Fold Here   Fold Here

First Name **M.I.**

Last Name **JR, SR, III, etc.**

Current Mailing Address:

House Number **Street Name**

Apartment Number / Private Mailbox **For Puerto Rico Only: Print Urbanization Name**

City **State** **ZipCode**

Previous Mailing Address (complete only if at current mailing address for less than two years):

House Number **Street Name**

Fold Here   Fold Here

Apartment Number / Private Mailbox **For Puerto Rico Only: Print Urbanization Name**

City **State** **ZipCode**

Shade Circle Like This →

Not Like This →

I want a credit report from (shade each that you would like to receive):

- **Equifax**
- **Experian**
- **TransUnion**

Shade here if, for security reasons, you want your credit report to include no more than the last four digits of your Social Security Number.

31238

If additional information is needed to process your request, the consumer credit reporting company will contact you by mail.

Your request will be processed within 15 days of receipt and then mailed to you.

General Tips

The Federal Trade Commission (FTC) is the nation's consumer protection agency. Here are some tips from the FTC to help you be a more savvy consumer.

1. **Know who you're dealing with.** Do business only with companies that clearly provide their name, street address, and phone number.
2. **Protect your personal information.** Share credit card or other personal information only when buying from a company you know and trust.
3. **Take your time.** Resist the urge to "act now." Most any offer that's good today will be good tomorrow, too.
4. **Rate the risks.** Every potentially high-profit investment is a high-risk investment. That means you could lose your investment — all of it.
5. **Read the small print.** Get all promises in writing and read all paperwork before making any payments or signing any contracts. Pay special attention to the small print.
6. **"Free" means free.** Throw out any offer that says you have to pay to get a gift or a "free" gift. If something is free or a gift, you don't have to pay for it. Period.
7. **Report fraud.** If you think you've been a victim of fraud, report it. It's one way to get even with a scam artist who cheated you. By reporting your complaint to 1-877-FTC-HELP or ftc.gov, you are providing important information to help law enforcement officials track down scam artists and stop them!

Federal Trade Commission
Bureau of Consumer Protection
Division of Consumer and Business Education