

## OLDER CONSUMERS' ATTITUDES TOWARD THE USE OF CREDIT SCORES

### BACKGROUND

Credit scores, once used nearly exclusively by the credit card industry, are now used by a wide range of industries. Mortgage companies and other lenders use these scores extensively. Beyond lending, auto and home insurers, utility companies, landlords, and employers are increasingly accessing consumers' credit scores in making business decisions. The Fair Credit Reporting Act (FCRA)<sup>1</sup> entitles consumers to free annual credit reports from each of the three major credit bureaus.<sup>2</sup> Consumers' credit reports include the credit information used to generate credit scores.

Accurate credit scores are efficient and have substantially improved the overall quality of many credit decisions.<sup>3</sup> Use of these scores and underlying technology has allowed automation of many lending decisions, price quotes, and other business transactions, which has lowered costs and reduced the time required for credit decision making.

However, research remains inconclusive on several key issues regarding credit scores, including accuracy, consistency, fairness, and potential racial/ethnic discrimination. In fact, a recent study by the Government Accountability Office (GAO) concluded, "publicly available information about the extent of data quality problems has been

limited, as has research on the effects of those problems."<sup>4</sup> It is anticipated that results from a forthcoming report by the Federal Trade Commission (FTC)<sup>5</sup> will offer extensive and rigorous research findings about credit scores and their impact on the marketplace.

Similarly, the accuracy of credit scores has been debated. Studies have examined the accuracy of credit reports from which credit scores are calculated. Some of these studies report low credit report error rates, especially those errors that result in adverse outcomes for borrowers,<sup>6</sup> while others report much higher error rates.<sup>7</sup> In addition, substantial inconsistencies have been noted among consumers' credit scores from the three credit bureaus.<sup>8</sup> These are often due to a lack of reporting of consumers' credit activity by creditors to credit bureaus, which results in incomplete consumer files.

There is also debate over fairness of the use of credit scores, especially for non-lending purposes. For example, the question is raised whether two people with similar driving

<sup>1</sup> FCRA (15 U.S.C. §1681 et seq.) was amended by the Fair and Accurate Credit Transactions Act of 2003 (FACT Act) Public Law 108-159.

<sup>2</sup> Experian, Equifax, and TransUnion. For an additional fee, consumers may also obtain their credit score.

<sup>3</sup> Avery, R., Calem, P., and Canner, G. Credit Report Accuracy and Access to Credit. *Federal Reserve Bulletin*, Summer 2004, pp. 297–322.

<sup>4</sup> General Accounting Office (2003). Consumer Credit: Limited Information Exists on the Extent of Credit Report Errors and Their Implications for Consumers. Report prepared for the Senate Committee on Banking, Housing, and Urban Affairs, GAO-03-1036T, July 31, pp. 1–18. In 2004, the General Accounting Office became the Government Accountability Office.

<sup>5</sup> As required by the Fair and Accurate Credit Transaction Act of 2003, Pub. L. No. 108-159 (2003).

<sup>6</sup> Avery, Calem, and Canner, G. 2004.

<sup>7</sup> For example: 1) Consumer Federation of America/National Credit Reporting Association. Credit Score Accuracy and Implications for Consumers, December 17, 2002, and 2) Public Interest Research Group. Mistakes Do Happen, March 1998.

<sup>8</sup> Consumer Federation of America/National Credit Reporting Association, 2002.

records should pay different auto insurance premiums solely because one person pays utility bills late, thus lowering his or her credit score. While there are correlations between low credit scores and payouts in the auto insurance industry,<sup>9</sup> there is no evidence of causation. (It should be noted that there is debate whether causation is the appropriate standard or if correlation is adequate.)<sup>10</sup> Other experts suggest that credit scores, in fact, are inappropriate proxies for other consumer characteristics.<sup>11</sup>

While on the one hand, some studies conclude that scores are not discriminatory,<sup>12</sup> others conclude that credit scores (including the credit reporting data and the models used to calculate credit scores) are innately biased.<sup>13</sup> The Federal Reserve Board concluded that while, overall, the proportion of individuals affected by any single type of data problem appears to be small, those individuals living in

minority neighborhoods experience a higher incidence of problems related to credit score errors.<sup>14</sup>

It is surprising, however, given the rigor of the ongoing debate on these issues, that none of these studies has examined consumers' attitudes toward the increased use of credit scores.

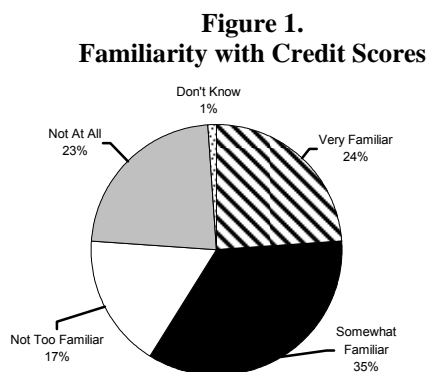
## METHODOLOGY

This data digest reports results from a national random sample of respondents age 18 and older regarding their attitudes and beliefs about the use of credit scores.<sup>15</sup> An opening screener question was asked about familiarity with credit scores; the survey was terminated for persons who reported to be not too or not at all familiar with credit scores.

## FINDINGS

### Familiarity with Credit Scores

Almost two-thirds of respondents 18 and older (59 percent) reported being either somewhat or very familiar with how banks, mortgage companies, and other businesses use credit scores (Figure 1).



n = 1,722 respondents age 18 and older.  
AARP Public Policy Institute, 2004

<sup>9</sup> Correlation between Credit Risk and Insurance Loss. Bureau of Business Research. University of Texas McCombs School of Business, 2003.

<sup>10</sup> Birnbaum, B. Comments for the Florida Insurance Commissioner's Task Force on Credit Scoring. The Center for Economic Justice, January 23, 2002.

<sup>11</sup> Birnbaum, B. Credit Scoring: 21st Century Redlining and the End of Insurance. Presented at the Conference on Computers, Freedom, and Privacy. Overseeing the Poor: Technology Privacy Invasion of Vulnerable Groups.

<sup>12</sup> For example: 1) The Use of Insurance Credit Scoring in Automobile and Homeowners Insurance. A Report to the Governor, the Legislature and the People of Michigan, December 2002, and 2) Predictiveness of Credit History for Insurance Loss Ratio Relativities. Fair Isaac, 1999.

<sup>13</sup> For example: 1) Kabler, B. State of Missouri Department of Insurance. Insurance-Based Credit Scores: Impact on Minority and Low Income Populations in Missouri, January 2004; 2) Collins, M., Harvey, K., and Nigro, P. The Influence of Bureau Scores, Customized Scores, and Judgmental Review on the Bank Underwriting Decision-Making Process. Office of the Comptroller of the Currency, Sept/Oct 2002; and 3) State of Washington Office of Insurance Commissioner. Effect of Credit Scoring on Auto Insurance Underwriting and Pricing. A Report to the Legislature, Washington State University, January 2003.

<sup>14</sup> Avery, Calem, and Canner, 2004.

<sup>15</sup> AARP's credit report telephone survey was conducted October 20–26, 2004, among a nationally representative sample of 1,722 adults age 18 and older. CR/International Communications Research of Media, PA, conducted all field work.

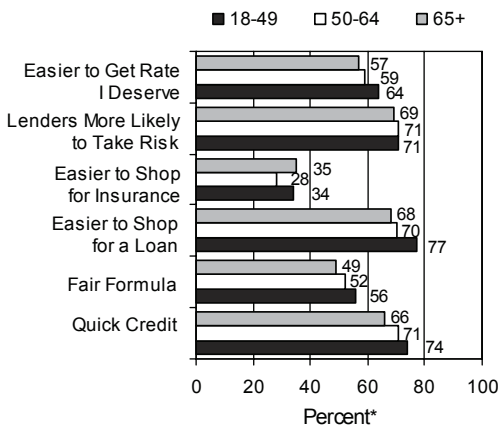
Persons age 65 and older were much less likely (39 percent) than were persons younger than 65 (67 percent) to report being somewhat or very familiar with credit scores.

### Potential Advantages and Disadvantages of Credit Scores

Respondents who reported being somewhat or very familiar with credit scores were asked to report how strongly they agreed or disagreed with each of 11 items (six potential advantages and five potential disadvantages) regarding credit scores.

With respect to the six potential advantages, “credit scores make it easier to shop for insurance” and “the formulas used to generate scores are fair” (Figure 2) were least likely to be reported as advantages. Younger persons were slightly more likely than were older persons to report each of the six as advantages, “easier to shop for insurance” being the exception.

**Figure 2.**  
Potential Advantages of Credit Scores

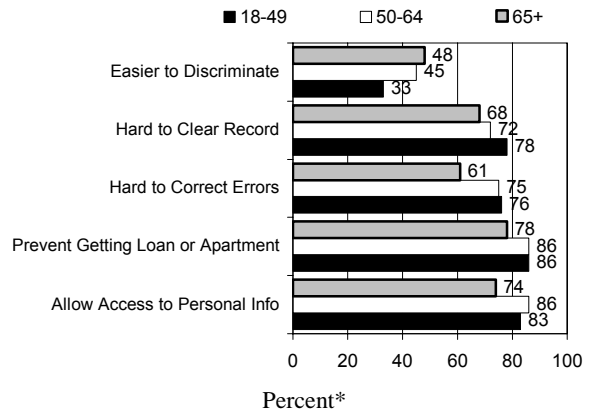


\*Percent includes respondents who somewhat or strongly agreed with each potential advantage. n = 998 respondents age 18 and older who reported being somewhat or very familiar with credit scores. AARP Public Policy Institute, 2004

Of the five potential disadvantages, only “easier to discriminate” was reported to be a disadvantage by less than half of all respondents, with younger persons less likely

to view this as a disadvantage than older persons (Figure 3).

**Figure 3.**  
Potential Disadvantages of Credit Scores



\*Percent includes respondents who somewhat or strongly agreed with each potential disadvantage. n = 998 respondents age 18 and older who reported being somewhat or very familiar with credit scores. AARP Public Policy Institute, 2004

Overall, respondents were somewhat more likely to agree with the potential disadvantages than with the potential advantages.

### Perceived Accuracy of Credit Scores

More than half (54 percent) of respondents believed that credit scores, *in general*, are an accurate representation of creditworthiness. Approximately one in five (18 percent) persons age 65 and older reported not knowing if credit scores are an accurate representation of creditworthiness, nearly three times the rate of younger persons (7 percent).

More than half (56 percent) of respondents reported having seen their *own* credit scores, with persons age 65 and older much less likely (34 percent) than younger persons (58 percent) to have done so. Of persons who had seen their own score:

- Eighty percent of persons age 65 and older reported that their own credit score accurately represented their creditworthiness, while two-thirds (63

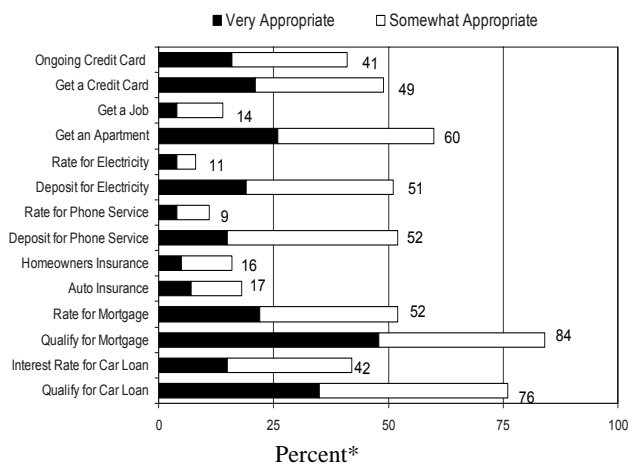
percent) of persons age 18–34 thought this to be the case.

- Three-fourths (74 percent) of all whites and less than one-half (48 percent) of blacks believed their own credit scores accurately represent creditworthiness. Only one-third (35 percent) of blacks age 50 and older believed this to be the case.

### Appropriate Uses of Credit Scores

Respondents were asked about the appropriateness of the use of credit scores for various purposes. More than three-fourths of respondents age 50 and older reported that the use of credit scores is appropriate for qualifying for mortgages (84 percent) and car loans (76 percent) (Figure 4).

**Figure 4.**  
Appropriate Use of Credit Scores

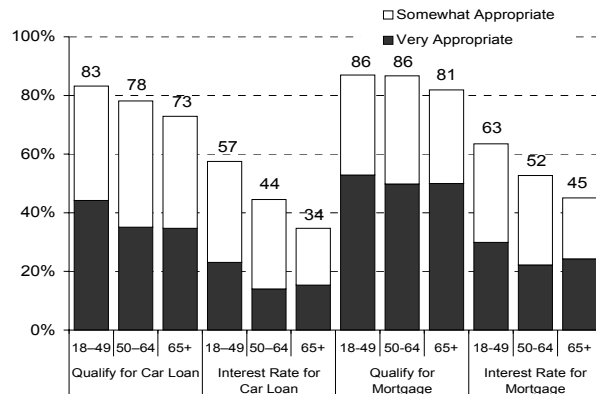


n = 423 respondents 50 and older.  
AARP Public Policy Institute, 2004

It is interesting to note that far fewer older respondents agreed that it is appropriate for credit scores to be used to *set* the interest rate than to *qualify* for both mortgages and car loans.

Older persons were less likely than younger persons to respond that the use of credit scores is very or somewhat appropriate for loan approval and setting interest rates (Figure 5).

**Figure 5.**  
Use of Credit Scores for Car and Home Loans by Age



n = 998 respondents age 18 and older.  
AARP Public Policy Institute, 2004

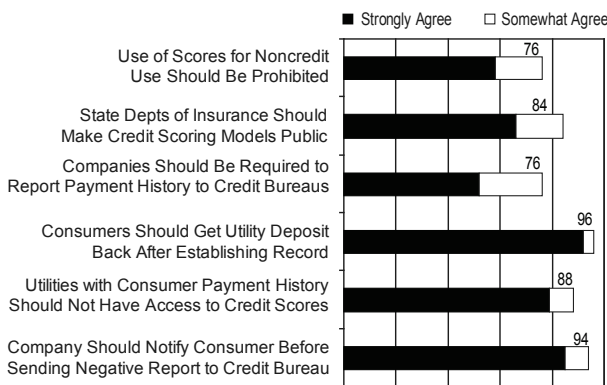
Respondents who answered that using credit scores is appropriate for qualifying for either a mortgage or a car loan but not for setting the interest rate were asked a follow-up, open-ended question. Overwhelmingly, the theme that emerged in the responses reported most often was that everyone should pay the same interest rate. Selected quotes that represent this theme include:

- “[Lenders] have a right to find out if you are legitimate enough to make car payments, but it would be inappropriate for them to be prejudiced on how much you pay.”
- “Either they give you a loan or they don’t. If they give it to you, it should have the same interest rate as any other persons.”
- “It should be used to determine if you can have a loan not the rate. The rate should be the market rate...not let the lender determine the rate used...”

### Policy Options

State policymakers have discussed a number of policy options regarding the use of credit scores. When respondents were asked if they agreed with each of six such policy options, more than three-fourths of those age 50 and older expressed agreement with each one. (Figure 6).

**Figure 6.**  
**Consumers' View of Proposed Policy Options**



n = 423 respondents 50 and older.  
AARP Public Policy Institute, 2004

## IMPLICATIONS

Credit scores play an increasingly important role in consumers' financial lives and can affect their economic security. Scores can affect both consumers' ability to get mortgage and non-mortgage credit and, equally important, the price they will have to pay for it. In addition to credit applications, credit scores are used increasingly for diverse business purposes such as determining auto insurance rates, hiring employees, and approving rental applications. In some states, utility companies may use credit scores to determine whether a deposit is required; Texas recently passed legislation that allows credit scores to be used to determine what rate consumers will have to pay for electricity.<sup>16</sup>

Several states have introduced legislation that would ban the use of credit scores for certain noncredit purposes, such as auto insurance or utility rate setting. Other states have passed legislation that mandates credit-scoring models be in the public domain so consumers can better understand how credit scores affect access to and pricing of products. At the federal level, there has been discussion about

<sup>16</sup> Subsequent legislation (HB412) was introduced during the 79th Texas legislature prohibiting electric companies from using credit scores to set prices.

the need for creditors to provide credit bureaus with complete and accurate data, so consumers can benefit from on-time payments, lower credit balances, and other behavior that should improve consumers' credit risk and, thus, their credit scores.

One concern the survey results raise is the possibility of a disparity between how consumers believe the market is working or should work and what is actually occurring in the marketplace today. This study found that many consumers who believe the use of credit scores is appropriate for determining if one is qualified for a loan also believe that for the use of such scores is inappropriate for setting prices- that is, they believe that "everyone should pay the same price." This belief contrasts starkly with current business practices that seek to apply risk-based pricing to a wide variety of goods and services. Such a disparity is of concern since, for the marketplace to work efficiently, consumers must adequately understand access to and pricing of credit.

In addition, the survey results raise concern about racial disparities in attitudes toward credit scores as an accurate representation of creditworthiness.

As a result of the FACT Act, consumers are entitled to free annual credit reports from each of the three major credit bureaus. This presents a significant opportunity to increase financial literacy. Improved credit score disclosure and notification policies are another way for policymakers to increase consumer awareness of the impact of credit scores on access and pricing. The survey results show strong public support for such policies.

Further, as the potential impact of credit scores becomes better understood, policymakers should seek to more fully address the issues of discrimination, accuracy, consistency, and fairness.

**Written by Sharon Hermanson and Ann Jackson**

**AARP Public Policy Institute**

601 E Street NW

Washington, DC 20049

202-434-3910; E-Mail: [ppi@aarp.org](mailto:ppi@aarp.org)

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