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FACT FILE
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WHAT'S YOUR NUMBER? CREDIT SCORES AND FINANCIAL SECURITY

One number can decide where you live, how much you can borrow and even, in some cases, whether you can land a job.

Credit scores are becoming an increasingly important determinant of who can get ahead financially—and who cannot. Unfortunately, a growing number of Americans are paying the price of poor credit with higher interest rates and less economic opportunity.

NUMBERS TO KNOW:

42%: The share of Americans who've seen their credit score in the last year.

56%: The percentage of Americans with "subprime" credit.

Sources: Consumer Federation of America; CFED Assets & Opportunity Scorecard

FACT: A majority of Americans have less-than-stellar credit.

While many Americans may not think of their credit rating as "subprime," the reality is that most Americans don't, in fact, have perfect credit. Far from it. CFED's 2012 Assets & Opportunity Scorecard found that 55.8% of Americans had credit scores at or below 700, based on data from the credit reporting agency TransUnion.[1] Moreover, in places such as Texas, Nevada and Mississippi, as many as two-thirds of residents have subprime credit. Even in the nation's most "credit-worthy" state, North Dakota, 42% of residents had subprime scores.

FACT: A small drop in credit scores can cost consumers thousands.

The price of having poor credit can be measured both in lost opportunities and lost dollars. According to a 2010 survey by the Society for Human Resource Management, 13% of employers conduct credit checks on all job candidates, while 47% check the credit of select hires (especially those who'll have access to confidential or financial information).

For landlords, home and auto insurance companies, telephone and utility service providers, both credit scores and credit reports—the data underlying the scores—are important sources of information in deciding whether to offer service and on what terms.

[1] Different credit reporting agencies use slightly different credit score scales. A score of 700 on TransUnion's "TransRisk" scale—which is considered "subprime"— is roughly comparable to a score of 640 on the better known "FICO" scale.

Most significantly, credit scores determine whether consumers can get a loan and how much they will pay. For example, the following table from FICO shows the difference that even a 20-point change in credit scores can make in the cost of a 30-year, fixed-rate mortgage:

FICO Score	Annual interest rate	Monthly payment	Total interest paid
760-850	2.931%	$418	$50,441
700-759	3.153%	$430	$54,764
680-699	3.33%	$440	$58,259
660-679	3.544%	$452	$62,542
640-659	3.974%	$476	$71,330
620-639	4.52%	$508	$82,835

Source: FICO Loan Calculator (Interest rates as of Nov. 2012).

Overall, the difference between "prime" credit and barely creditworthy is $32,394 in additional interest over the life of the loan—or enough to pay for nearly two years of tuition, fees, room and board at a public four-year college.

FACT: Lower-income consumers have a tougher time improving their credit.

A major reason many Americans have lower scores than they should is lack of knowledge. One survey by the Consumer Federation of America (CFA) found that while most people understand the importance of a credit score, they harbor serious misperceptions about the consequences of a low score and what can affect someone's credit rating. For example, the CFA found that more than half of Americans think that age and marital status affect credit scores (56% and 54%), and only 29% knew how costly a low score can be. Moreover, with fewer than half (42%) of consumers having obtained or seen their score in the last year, many Americans may not be monitoring their credit vigilantly.

But for lower-income consumers, the barriers to building credit run much deeper. Credit scores are essentially judgments on a person's creditworthiness based on his or her credit history—how long the consumer has had credit, how many accounts are held and whether bills are paid on time. Many lower-income consumers, however, can't get past the initial threshold of getting credit at all.

For one thing, lower-income consumers are less likely to be connected to the financial mainstream with a savings or checking account (see CFED's Fact File, *Unaccounted*), which makes it much tougher to get a traditional credit card. Virtually every credit card application requires bank account information.

Second, credit reporting agencies don't always collect all of the information that can help establish a lower-income consumer as a good credit risk. For example, lower-income consumers are more likely to be renters than homeowners.

But while paying a mortgage on time can burnish your credit, paying rent on time may not. Negative information, such as evictions or collections, has always been included in credit reports. But it wasn't until December 2010 that Experian became the first credit reporting agency to include *positive* rental payment data as well. Even then, it's only from landlords choosing to report it. Likewise, credit agencies don't collect on-time payment data from utilities and phone companies (although they do report people referred to collections because they don't pay their bills).

Some organizations, such as PERC, argue that this "alternative data" can be an effective way to measure the creditworthiness of Americans whose traditional credit history is lacking or meager (a "thin file" consumer). As long as good credit is a passport to economic mobility, expanding opportunities to build credit can only serve to expand opportunity.

Resources

- CFED, Assets & Opportunity Scorecard – Consumers with Subprime Credit.
- PERC, A New Pathway to Financial Inclusion, June 2012.
- www.myFICO.com, Loan Savings Calculator.
- Federal Trade Commission, Consumer Information - Credit Reports and Scoring.
- Consumer Financial Protection Bureau, Credit Reports and Scores.

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