

# FTC Facts

## For Consumers



FEDERAL TRADE COMMISSION  
FOR THE CONSUMER

[www.ftc.gov](http://www.ftc.gov) ■ 1-877-ftc-help

August 2005

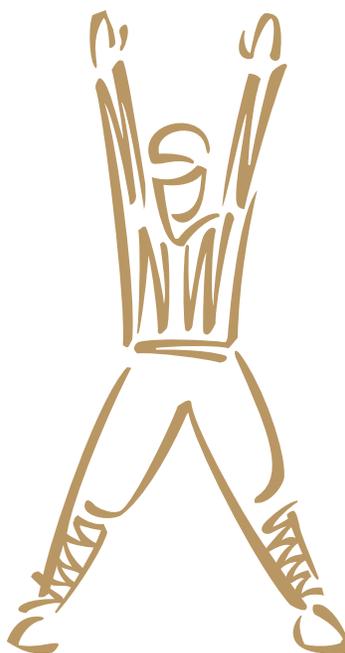
## Credit Scoring

Ever wonder how a creditor 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 and auto loans. More recently, credit scoring has been used to help creditors evaluate your ability to repay home mortgage loans. Here's how credit scoring works in helping decide who gets credit — and why.

### What is credit scoring?

Credit scoring is a system creditors use to help determine whether to give you credit.

Information about you and your credit experiences, such as your bill-paying history, the number and type of accounts you have, late payments, collection actions, outstanding debt, and the age of your accounts, is collected from your credit application and your credit report. Using a statistical program, creditors compare this information to the credit performance of consumers with similar profiles. 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, that is, how likely it is that you will repay a loan and make the payments when due.

Because your credit report is an important part of many credit scoring systems, it is very important to make sure it's accurate before you submit a credit application. An amendment to the federal Fair Credit Reporting Act (FCRA) requires each of the major nationwide consumer reporting companies to provide you with a free copy of your credit reports, at your request, once every 12 months.

Free reports have been phased in during a nine-month period, starting with the states in the West and ending with states in the East. Beginning September 1, 2005, free reports will be accessible to all Americans, regardless of where they live.

To order your free annual report from one or all national consumer reporting companies, visit [www.annualcreditreport.com](http://www.annualcreditreport.com), call toll-free 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 [ftc.gov/credit](https://ftc.gov/credit). Do not contact the three nationwide consumer reporting companies individually. They provide free annual credit reports only through 877-322-8228, [www.annualcreditreport.com](https://www.annualcreditreport.com), and Annual Credit Report Request Service, P. O. Box 105281, Atlanta, GA 30348-5281.

If you're not yet eligible for a free annual credit report, a consumer reporting company may charge you up to \$9.50 for each copy.

To buy a copy of your report, contact:

- **Equifax:** 800-685-1111; [www.equifax.com](https://www.equifax.com)
- **Experian:** 888-EXPERIAN (888-397-3742); [www.experian.com](https://www.experian.com)
- **TransUnion:** 800-916-8800; [www.transunion.com](https://www.transunion.com)

For more information, see *Your Access to Free Credit Reports* at [ftc.gov/credit](https://ftc.gov/credit).

### Why is credit scoring used?

Credit scoring is based on real data and statistics, so it usually is more reliable than subjective or judgmental methods. It treats all applicants objectively. Judgmental methods typically rely on criteria that are not systematically tested and can vary when applied by different individuals.

### How is a credit scoring model developed?

To develop a model, a creditor selects a random sample of its customers, or a sample of similar customers if their sample is not large enough, and analyzes it statistically to identify characteristics that relate to creditworthiness. Then, each of these factors is assigned a weight based on how strong a predictor it is of who would be a good credit risk. Each creditor may use its own credit scoring model, different scoring models for different types of credit, or a generic model developed by a credit scoring company.

Under the Equal Credit Opportunity Act (ECOA), a credit scoring system may not use certain characteristics — like race, sex, marital status, national origin, or religion

— as factors. However, creditors are allowed to use age in properly designed scoring systems. But any scoring system that includes age must give equal treatment to elderly applicants.

### What can I do to improve my score?

Credit scoring models are complex and often vary among creditors and for different types of credit. If one factor changes, your score may change — but improvement generally depends on how that factor relates to other factors considered by the model. Only the creditor can explain what might improve your score under the particular model used to evaluate your credit application.

---

*Many scoring models evaluate the amount of debt you have compared to your credit limits.*

---

Nevertheless, scoring models generally evaluate the following types of information in your credit report:

- *Have you paid your bills on time?* Payment history typically is a significant factor. It is likely that your score will be affected negatively if you have paid bills late, had an account referred to collections, or declared bankruptcy, if that history is reflected on your credit report.
- *What is your outstanding debt?* Many scoring models evaluate the amount of debt you have compared to your credit limits. If the amount you owe is close to your credit limit, that is likely to have a negative effect on your score.
- *How long is your credit history?* Generally, models consider the length of your credit track record. An insufficient credit history may have an effect on your score, but that can be offset by other factors, such as timely payments and low balances.
- *Have you applied for new credit recently?* Many scoring models consider whether you have applied for credit recently by looking at “inquiries” on your credit report when you apply for credit. If you have applied for too many new accounts recently, that may negatively affect your score. However, not all inquiries are counted. Inquiries by creditors who are monitoring your account or looking at credit reports to make “prescreened” credit offers are not counted.

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

Scoring models may be based on more than just information in your credit report. For example, the model may consider information from your credit application as well: your job or occupation, length of employment, or whether you own a home.

To improve your credit score under most models, concentrate on paying your bills on time, paying down

outstanding balances, and not taking on new debt. It’s likely to take some time to improve your score significantly.

### **How reliable is the credit scoring system?**

Credit scoring systems enable creditors to evaluate millions of applicants consistently and impartially on many different characteristics. But to be statistically valid, credit scoring systems must be based on a big enough sample. Remember that these systems generally vary from creditor to creditor.

Although you may think such a system is arbitrary or impersonal, it can help make decisions faster, more accurately, and more impartially than individuals when it is properly designed. And many creditors

---

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

---

design their systems so that in marginal cases, applicants whose scores are not high enough to pass easily or are low enough to fail absolutely are referred to a credit manager who decides whether the company or lender will extend credit. This may allow for discussion and negotiation between the credit manager and the consumer.

### **What happens if I am denied credit or don't get the terms I want?**

If you are denied credit, the ECOA requires that the creditor give you a notice that tells you the specific reasons your application was rejected or the fact that you have the right to learn the reasons if you ask within 60 days. Indefinite and vague reasons for denial are illegal, so ask the creditor to be specific. Acceptable reasons include: "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."

If a creditor says you were denied credit because you are too near your credit limits on your charge cards or you have too many credit card accounts, you may want to reapply after paying down your balances or closing some accounts. Credit scoring systems consider updated information and change over time.

Sometimes you can be denied credit because of information from a credit report. If so, the FCRA requires the creditor to give you the name, address and phone number of the consumer reporting company

that supplied the information. You should contact that company to find out what your report said. This information is free if you request it within 60 days of being turned down for credit. The consumer reporting company can tell you what's in your report, but only the creditor can tell you why your application was denied.

If you've been denied credit, or didn't get the rate or credit terms you want, ask the creditor if a credit scoring system was used. If so, ask what characteristics or factors were used in that system, and the best ways to improve your application. If you get credit, ask the creditor whether you are getting the best rate and terms available and, if not, why. If you are not offered the best rate available because of inaccuracies in your credit report, be sure to dispute the inaccurate information in your credit report.

### **Where can I get more information or file a complaint?**

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 [ftc.gov](http://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.



# 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](https://www.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  
Office of Consumer and Business Education*