Contrary to Popular Belief . . .

Younger consumers are frequently encouraged to monitor and maintain their credit scores, but conventional wisdom holds that managing consumer credit is less important for seniors. Conventional wisdom is wrong.

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Financial institutions and other organizations factor consumer credit scores into a wide range of decisions, from traditional lending activities to leasing, insurance, and employment decisions. Although consumers are generally aware that low credit scores can result in higher borrowing costs or denial of credit, many don't realize that a low score can result in higher insurance premiums, adverse leasing decisions, or even denial of employment.

The practice of considering credit scores in financial decision making has become pervasive. Young people are routinely counseled to develop and maintain solid credit histories, but the need for older Americans to maintain satisfactory scores gets less attention. Seniors tend to have a lower risk tolerance, less future earning power, the potential to need large amounts of emergency medical funding, and less time to recover from financial losses. As a result, maintaining financial "slack" may be as important—if not more important—for older consumers than for younger people. Seniors need to be able to raise funds quickly, perhaps by borrowing. For this reason, they need to maintain a solid credit record, and they need to routinely monitor their credit files.

Where conventional wisdom fails

"Individual financial management" is the subset of finance that focuses on economic issues facing households. The finances of senior households merit special consideration. Senior households are usually one- or two-person units and generally have no, or very limited, employment income. Also, in these times of record-low interest rates on assets with fixed returns, seniors are more likely to confront the "longevity problem." This means that many will reduce their asset holdings over time to meet their day-to-day expenses through the end of life, but they obviously don't know when the end of life will happen.

Conventional wisdom expects young adults to focus on asset accumulation, education for children, and retirement saving, while assuming that seniors have little or no debt, incur lower living expenses (health expenditures aside), and possess significant nest eggs after decades of saving and investment. But this conventional wisdom has been undermined by governmental statistics. Prudence suggests that we should retire with little debt. According to the latest available Consumer Expenditure Survey (CES), however, the proportion of Americans over age 65 with outstanding mortgage debt has increased over time, from 16 percent in 1990 to more than 20 percent in 2009 (U.S. Bureau of Labor Statistics, 2009). Results from a recent FINRA survey are even more dramatic: 34 percent of those age 60 and above reported having a home mortgage (FINRA Investor Education Foundation, 2009). At the same time, real estate values—and, therefore, seniors' home equity—have dropped precipitously since peaking in 2006. In sum, a substantial proportion of seniors maintain significant debt into their 60s and beyond, and they have less ability than in the past to monetize their home's equity via sale or reverse mortgage.

Conventional wisdom also holds that our household expenditures should be lower in retirement than in our working years. A majority of workers expect their post-retirement expenditures to fall relative to their pre-retirement spending, but this is another area in which reality does not always match expectations. In a recent survey, about half of retirees reported that their spending in retirement is the same as or greater than it was before retiring (Employee Benefits Research Institute, 2010).

Compounding the problem, cash flow for senior households has been under pressure in recent years. Health-care costs continue to skyrocket; employers continue to cut back on post-retirement health benefits; and municipalities are raising property taxes to offset declining revenues. At the same time, traditional income sources have failed to keep up. Social Security recipients received no cost-of-living adjustments in 2009 or 2010, and financial markets have not been favorable to savers. Interest rates are at historically low levels, and equity market conditions have been largely unfavorable for more than a decade.

The bottom line is that recent events have made financial management more important—and difficult—for senior households. Seniors today must exercise greater care than ever before in managing their finances. In particular, they must be prepared to raise funds quickly in the event of an emergency. Like other households, seniors should maintain three to six months' expenses in an emergency fund. They also need to maintain their credit rating—and, therefore, their ability to borrow in case of emergency. This requires paying close attention to the information in their consumer credit file and their consumer credit rating.

How consumer credit reporting works

When an American applies for credit or makes a payment on an existing account, the lender may report the activity to any of the three major credit reporting agencies (CRAs): Equifax, Experian, and TransUnion. The lender reports whether payments were made or missed, how late they were, any charge-offs, and any accounts sent for collection.

The detailed information in the CRA files is consolidated into a single number (a credit score) using proprietary statistical models. The FICO® score is the oldest and most widely used credit score in use today. In theory, the FICO score captures the impacts of a variety of variables and provides potential lenders with an unbiased and statistically valid assessment of consumer creditworthiness. According to Barry Paperno (2011), consumer affairs manager at myFICO.com, "A FICO score is a three-digit number between 300 and 850 that summarizes a person's credit risk based on [the information in] their credit report at a particular point in time. The number tells a prospective lender how likely someone will pay on time, with higher scores indicating lower risk and with lower scores indicating higher risk."

FICO scores are based on the following

consumer attributes, in descending order of importance (Fair Isaac Corporation, 2011):

- Payment history: timeliness, number of past dues, collection items, adverse public records, recentness of negative items, etc.
- Amounts owed: balances relative to credit limits, or "credit utilization rate"
- Length of credit history: time since accounts opened; time since account activity
- New credit: number of recent credit inquiries, accounts opened, etc.
- Types of credit used: revolving charges, mortgages, etc.

Several federal agencies, including the Federal Trade Commission (FTC), are involved in the oversight of credit reporting; however, assessment of the accuracy of the information in individual files is left largely to those believed best able to judge it: consumers themselves. Unfortunately, many consumers fail to review their reports regularly, and seniors are less likely than other age cohorts to do so. One study found that only one-third of respondents over age 60 had obtained a copy of their credit report in the preceding year, and just over 1 in 4 seniors had checked their credit score (FINRA, 2009). By comparison, almost half of those ages 30–59 had done so.

This lack of attention is troubling, given the potential for errors in consumer credit files. The U.S. Public Interest Research Group (USPIRG) reports that "79 percent of the credit reports surveyed contained either serious errors or other mistakes of some kind" and that one-fourth of credit reports surveyed "contained serious errors that could result in the denial of credit" (National Association of State PIRGs, 2004). Likewise, when Barry Avery, Paul Calem, Glenn Canner, and Robert Bostic (2003) reviewed a large sample of consumer credit data, they concluded that "close examination of credit reporting company data reveals that the information is not complete, may contain duplications, and at times contains ambiguities about the credit histories of at least some consumers."

Empirical evidence that seniors need "financial slack"

On behalf of the FTC, researchers at the University of Missouri–St. Louis, the University of Arizona, and the Fair Isaac Corporation have conducted two pilot studies to test research methodology for a national study on the accuracy of consumer credit data and the effects of errors on credit scores. In the second pilot study (Smith et al., 2008), we recruited individuals from 134 U.S. households and we reviewed their credit reports in depth to assess the reports' accuracy. If discrepancies were found, we filed formal disputes with the credit bureaus to request that alleged errors be corrected. In order to be eligible for participation in the study, a person had to be an adult who has been extended credit in the past. Our results from this study indicate that it is important for consumers to review their credit reports regularly.

Table 1, on page 57, shows the age breakdown of our sample, as well as the percentage of respondents who, at the time of the survey, were employed, owned homes, and had mortgages. All the respondents under age 30 were employed, a percentage that declines with age. Interestingly, over one-quarter of respondents in the highest age group were employed. This may be a result of the fact that the average retirement age has increased over the past two decades, from 62 to 64 for men and from 60 to 62 for women (Rosato, 2011). It may also be a reflection of recent economic

Table 1: Sample Characteristics of Surveyed Households, by Age of Head of Household

	Under age 30	Ages 31–40	Ages 41–50	Ages 51–60	Over age 60	Total
Proportion of all participants who fell into each age group	12.8%	20.1%	16.4%	20.1%	30.6%	100%
Proportion of each age group in which at least one person in the household was employed	100%	92.6%	86.4%	65.7%	27.3%	69.4%
Proportion of each age group who were homeowners	29.1%	59.3%	90.9%	91.4%	93.9%	77.6%
Proportion of each age group who had a mortgage	29.1%	55.6%	81.8%	57.1%	51.5%	60.0%

turmoil, or the pressure on income for many senior households, or a greater tendency for working seniors to agree to participate in a study that requires an intensive review of voluminous data.

The percentage of respondents who own their primary residence increases with age. More important is our finding that slightly more than half of those over age 60 have a home mortgage. In our survey, a substantially higher proportion of people over 60 have a mortgage (51.5 percent) than live in a household in which at least one person has a job (27.3 percent). This suggests that a significant number of seniors enter retirement with a substantial amount of outstanding debt, and some may have limited resources to repay that debt.

A survey conducted by the Consumer Federation of America and Providian Financial found that the majority of consumers are unaware of the distinction between a credit report and a credit score, and fewer than a third had checked their credit score in the preceding 12 months. In response to the survey results, Stephen Brobeck, executive director of the Consumer Federation of America, stated that "most consumers still do not know basic facts about credit scores and their financial significance" (Sullivan, 2006).

Taken in combination, the existence of substantial postretirement debt and limited financial expertise places seniors at considerable financial risk should they face unanticipated expenditures. In sum, our results emphasize seniors' need to maintain financial slack, including a credit score that allows them to borrow if necessary.

Errors commonly affect consumer credit scores

As the need to maintain a good credit score becomes increasingly important for seniors, they should be aware that reports may contain errors. After asking survey respondents to report on their financial expertise and household characteristics, we considered the information in their credit files. All participants in our study obtained their credit reports and FICO scores, then they reviewed them with the assistance of researchers. If consumers found items that they believed to be in error, they filed disputes with the CRAs to correct the issues.

The incidence of alleged errors among our study participants varied across age categories. Only 17.6 percent in the youngest age category found errors, whereas over 37 percent aged 51–60 found errors. More than a third of senior participants asserted that there were errors in their credit reports, as seen in Table 2, below. The average number of alleged errors for participants who filed disputes varied across age categories; those in the youngest group reported 4.5 errors, on average, while those in the senior group reported 2.4 errors. Across the entire pilot-study sample, consumers who filed disputes reported 2.7 errors, on average. The small size of the sample from which these statistics are derived precludes the drawing of general conclusions about the frequency of errors for U.S. consumers. The FTC has, however, commissioned a national study using this research methodology on a representative sample of U.S. consumers to produce statistics for that purpose. The results of this national study will become public in the FTC's report to the U.S. Congress late this year.

Some of the errors alleged by consumers were relatively minor (for example, an incorrect previous address) and had no impact on the respondent's FICO score (Smith et al., 2008). A significant number of the reports, however, included errors that could affect a respondent's credit score, such as erroneous reports of late payments and incorrect descriptions of collections activities. Fair Isaac froze disputed credit reports and rescored the respondents' FICO scores after making their requested changes. For classification purposes here, we consider errors to be "material" if the revised score increased by 10 or more points after the alleged errors were corrected.

The results in Table 2 indicate that errors can have a significant impact on consumers' credit histories and credit scores. In the pilot study, 33 percent of the participants alleged errors in at least one of their three credit reports, and in 25 percent of those cases (i.e., in 8 percent of the cases overall), the magnitude of the error in at least one of the credit reports was found to be of a material significance. Two-thirds of participants in the youngest group and one-sixth of participants in the over-60 group who alleged errors did so for items that would have had a material impact on at least one credit report. Although material errors might not occur as often in the senior age group, they do exist and the impact could be severe in the case of those who may need to borrow to cover an emergency financial need. Even a 10-point change in one's credit score can shift the consumer into a higher risk category, which can significantly increase the cost of borrowing or, at worst, result in the denial of credit.

How to review credit reports and improve scores

Credit reports can be confusing and intimidating to consumers of all ages. As a Certified Senior Advisor (CSA)®, you can help your clients—especially your senior clients—understand how they can obtain and review their credit reports, and, if needed, take action to correct them.

Table 2: Problems with Credit Reports, by Age of Head of Household

	Under age 30	Ages 31–40	Ages 41–50	Ages 51–60	Over age 60	Total
Percentage of participants whose credit files included at least one alleged error	17.6%	33.3%	31.8%	37.1%	36.4%	32.8%
Average number of alleged errors per participant who filed a dispute	4.5	2.4	2.5	2.7	2.4	2.7
Percentage of cases in which alleged errors were material (i.e., reduced at least one credit score by 10 or more points)	66.7%	33.3%	28.6%	15.4%	16.7%	25.0%

Table 3: Americans' FICO Scores, by Quintile of the Population

Quintile	Range of FICO scores
1st quintile—least creditworthy	300–589
2nd quintile	590–679
3rd quintile	680–749
4th quintile	750–789
5th quintile—most creditworthy	790–850

First, clients should obtain their credit reports from each credit reporting agency. Under 2003 amendments to the Fair Credit Report Act (FCRA), consumers can obtain copies of their credit reports at no cost by going to www.annualcreditreport.com. Rotating among the three bureaus in four-month periods keeps the check current. A client should begin walking through each of her credit reports by examining the personal information on the first page: name, Social Security number, current and previous addresses, and employment data. Consumers should verify that all this information is correct to ensure that their credit report has not been erroneously merged with data of other individuals with similar names or addresses.

Next, your client should review her reports to verify financial information, including the number of listed credit accounts, late payments, and outstanding balances. If your client finds inaccuracies, she should dispute them. Detailed information about the process for disputing credit reports can be found in the October 2011 "FTC Facts for Consumers." When a consumer files a dispute, the CRA whose report contains the alleged error must respond within 30 days, either by correcting the error or by explaining why it will not change the consumer's information.

Individuals with negative items in their credit reports can benefit from checking their credit scores and determining how to improve them. Every lender has its own method for determining how much credit risk it is willing to accept from consumers, so it's impossible to define what constitutes an unequivocally "good" or "bad" credit score outside the context of a particular lending scenario. That said, Fair Isaac reports quintiles, which may be considered roughly analogous to national norms. Table 3, above, shows the FICO scores that equate to each quintile.

Each consumer's FICO score report includes indicators related to the individual's score. The first page contains a summary of the person's credit history, along with descriptors such as "very good," "good," and so forth. Next the report includes a summary listing the number of accounts the consumer holds, the number of late payments reported, the accounts in collections, and similar data. Items that have a serious negative impact on the individual's credit score are accompanied by a small flag symbol; improving these areas is key to improving the consumer's overall FICO score.

The final—and perhaps most important—way that a CSA can help is to encourage a client to improve her credit score, if necessary. Consumers improve their scores by making payments on time, reducing their level of credit utilization by paying down outstanding balances, and minimizing the number of inquiries for new credit. Note that closing credit accounts does not necessarily improve a person's credit score; in fact, it can reduce a consumer's appearance of creditworthiness. When an individual closes one or more accounts, she decreases her amount of available credit. If she maintains the same dollar value of outstanding balances across all her credit accounts, closing the accounts will actually increase her credit utilization rate. Moreover, closing older accounts may shorten a person's reported credit history, which also appears to diminish her creditworthiness.

Prudent financial management requires consumers to monitor their credit reports regularly. Despite the widespread belief that seniors have less need for borrowing than people in other age groups, many need access to credit to tide them over in the event of a medical or other financial emergency. Seniors who ignore their credit files do so at their own risk. One of the most important ways in which CSAs can support their senior clients' financial stability into the future is to help them understand the importance of maintaining a solid credit record and the process of obtaining, reviewing, and correcting their credit reports.

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