

Answers to Your Questions About Credit Scoring

WHAT IS A CREDIT SCORE?

A credit score is a number lenders use to help them decide: “If I give this person a loan or credit card, will I get paid back on time?” It is one of several pieces of information that auto, mortgage, credit card and other lenders use when evaluating your application for credit.

There are different types of credit scores. Credit bureau scores (see box below) are based solely on information in consumer credit reports – they are NOT a part of a consumer credit report. Other types of scores may also include information from credit applications or bank files. A credit score is calculated by a computer in your bank or at one of the national credit bureaus when a lender requests it.

A score is a snapshot of your credit risk picture at a particular point in time. It changes as new information is added to your credit bureau report or bank file. Only information that is proven to be predictive of future credit performance is used.

WHAT’S IN A CREDIT BUREAU SCORE?

Credit bureau scores are based on 5 main categories of credit information. The relative importance of each is as follows:

- 1st – Late payments, collections, bankruptcies
- 2nd – Outstanding debt
- 3rd – Length of credit history
- 4th – Types of credit in use
- 5th – New applications for credit

WHAT’S NOT?

U.S. Law is very specific about what cannot go into a credit score. The following information cannot go into a credit score: Race, Religion, Gender, Martial status, Birthplace.

WHY DO LENDERS USE CREDIT SCORES?

Credit scores give lenders a fast, objective measurement of an applicant’s credit risk. Before the use of scoring, the credit granting process was usually slow, inconsistent and often unfairly biased.

Lenders can use scores to speed up loan approvals to borrowers who score above a certain threshold. Borrowers with scores just at the threshold or below may be asked to submit additional information or may qualify for different terms. Many lenders offer a choice of credit products geared to different risk levels. Most have their own separate guidelines, so if you are turned down by one lender, another may approve your loan.

SPEEDY LOAN DECISIONS

Credit scoring and computerized application processing help lenders deliver speedy decisions to applicants applying for credit or a loan.

WHAT IS A GOOD SCORE TO GET?

A “good” score is a number that matches the level of risk a lender is willing to accept for a particular loan or credit card. For example, a score of 750 may qualify you for a gold credit card, whereas a score of 675 may indicate you’re a better match for a standard card. Scoring systems have varying numeric scales. A score of 875 could indicate high risk in one system and low risk in another. It’s hard to say what’s a good score to get – it varies from lender to lender.

HOW CAN I FIND OUT MY SCORE?

Some lenders may tell you your score. However, **a score in isolation does not provide much information. Scores are dynamic and change when new information is added to the credit file.** Also, lenders use different types of scores with varying numeric scales. In addition, other factors, like application information, impact lenders’ credit decisions. Remember, what’s considered an acceptable score varies from lender to lender depending on the loan or credit card applied for.

HOW CAN I IMPROVE MY CREDIT SCORE?

Scores reflect credit payment patterns over time with more emphasis on recent information.

To improve a score:

- 1) Pay your bills on time. Delinquent payments and collections can have a major negative impact on a score.
- 2) Keep balances low on unsecured revolving debt like credit cards. High outstanding debt can affect a score.
- 3) Apply for and open new credit accounts only as needed.

Your credit snapshot will improve over time if you make changes now in the way you handle credit. Make sure the information in your credit report is correct, too. If you find errors, contact the credit bureau and your lender.

WHAT IF I’M TURNED DOWN FOR CREDIT?

While lenders are not required to disclose a score, if you have been turned down for credit, the Equal Credit Opportunity Act (ECOA) requires that you be given the reasons why within 30 days. Possible reasons a score is too low might include recent late payments or too much outstanding credit. You are also entitled to a free copy of your credit bureau report within 60 days. If your credit application was turned down, or you didn’t qualify for the interest rate you wanted, ask your lender how you can improve your credit picture.

WHAT IF THE INFORMATION IN MY CREDIT REPORT IS WRONG?

You should make sure the information in your credit report is correct. Review your credit report from each credit bureau at least once a year and especially before making a large purchase, like a house or car. Call these numbers to request a copy:

Equifax: (800) 685-1111

Trans Union: (800) 888-4213

Experian (formerly TRW): (800) 422-4879

If you find an error, the bureau must investigate and respond to you within 30 days. If you are in the process of applying for a loan, immediately notify your lender of any incorrect information in your report. Small errors may have little or no effect on your score. If there are significant errors, however, the lender may disregard the score.

SCORING FACTS AND FALLACIES

FALLACY: With credit scoring, computers are making the lending decisions.

FACT: *Computers don't make lending decisions, lenders do. Computers analyze credit information to produce a score, but individual lenders decide what scores are acceptable for different loans or credit cards. Some lenders accept higher risk applicants. Some use scores to help determine when to request more information from the applicant.*

FALLACY: A poor score will haunt me forever.

FACT: *Just the opposite is true. A score is a "snapshot" of your risk at a particular point in time. It changes as new information is added to your bank and credit bureau files. Scores change gradually as you change the way you handle credit. For example, past credit problems impact your score less as time passes. Lenders request a current score when you submit a credit application, so they have the most recent information available.*

FALLACY: Credit scoring is unfair to minorities.

FACT: *Scoring considers only credit-related information. Factors like gender, race, nationality and marital status are not included. In fact, the Equal Credit Opportunity Act (ECOA) prohibits lenders from considering this type of information when issuing credit.*

Independent research has been done to make sure that credit scoring is not unfair to minorities or people with little credit history. Scoring has proven to be an accurate and consistent measure of repayment for all people who have some credit history. In other words, at a given score, non-minority and minority applicants are equally likely to pay as agreed.

FALLACY: Credit scoring infringes on my privacy.

FACT: *Credit scoring evaluates the same information lenders already look at – the credit bureau report, credit application and/or your bank file. A score is simply a numeric summary of that information. Lenders using scoring sometimes ask for less information – fewer questions on the application form, for example.*

FALLACY: My score will drop if I apply for new credit.

FACT: *Probably not much. If you apply for several credit cards within a short period of time, multiple requests for your credit report information (called “inquiries”) will appear on your report. Looking for new credit can equate with higher risk, but most credit scores are not affected by multiple inquiries from auto or mortgage lenders within a short period of time. Typically, these are treated as a single inquiry and will have little impact on the credit score.*

SOURCE: Fair, Isaac & Company, Inc.