Can You Underwrite The Risk Without A Score Card?

Okay, so you decide that the time is right to purchase that new Mercedes you've always dreamed of. Your friend down the street has one and he got a great deal on the interest rate for his car loan. You decide to go to the same dealer that your friend went to. The dealer sends you to the same lending institution for your loan. However, you discover that the interest rate they're offering you is considerably higher than your friend's. Why? Same car. Same dealer. Same lending institution. Well, the chances are good to excellent that the problem is with your credit score. However, there are steps you can take to raise your credit score, if you know what you're doing.

We've all read about the controversies over insurance scoring, a practice where an insurance company sets the premium for your automobile insurance based, at least in part, on your credit history. Consumer activists believe the practice is discriminatory, benefiting those who are more affluent while hurting the poor or those who have not yet built up a credit history — i.e. the younger population. Insurers, on the other hand, argue that scoring is a legitimate and necessary part of rate-setting. In addition, they say that credit scoring gives a fairer game for all. A high score can lower your interest payments, help you qualify for home or auto loans, and effectively increase your cash flow. A low FICO credit score can kill your wallet and squash dreams of a new home or car almost instantly. Until two years ago, the three major credit bureaus did not disclose FICO credit scores to the individuals they had graded. Using algorithms generated by FICO, the credit bureaus let prospective lenders get a peek under consumers' covers, so to speak, without telling the consumers what they were seeing. Now that the three credit bureaus have made the scores available, consumers can help themselves save money by increasing their credit scores," Snyder says.

So, how does FICO determine credit scores? Actually, according to FICO, the scores are calculated from a lot of different credit data in a particular credit report. This data are grouped into five categories and the percentages accompanying them demonstrate their importance to credit scoring. Payment history comes in as the most important at 35 percent. Amounts owed comes in second at 30 percent. Then there is length of credit history coming in at 15 percent and new credit and types of credit used, each coming in at 10 percent. However, FICO says that these percentages are based on the importance of the five categories for the general population. For particular groups — for example, people who have not been using credit long — the importance of these categories may be somewhat different.

FICO breaks down these categories further. For example, payment history would include: account payment information on specific types of accounts (credit cards, retail accounts, installment loans, finance company accounts, mortgage, etc.); presence of adverse public records (bankruptcy, judgments, suits, liens, wage attachments, etc.); collection items, and/or delinquency (past due items); severity of delinquency (how long past due); number of past due items on file; and the number of accounts paid as agreed. A similar breakdown is used for each of the other general categories.

But FICO points out that the importance of any factor depends on the overall information in a person's credit report. For some people, a given factor may be more important than someone else with a different credit history. In addition, as the information in a person's credit report changes, so does the importance of any factor in determining a person's score. Thus, it's impossible to say exactly how important any single factor is in determining a person's score. Moreover, FICO emphasizes that a person's score considers both positive and negative information in the credit report. Late payments will lower the score, but establishing or re-establishing a good track record of making payments on time will raise a person's score.

The credit scores determined by FICO are purchased by the credit bureaus, who then use additional information (i.e. a person's income, length of time at a job or the kind of credit being requested) to interpret the FICO scores, so each credit bureau may have a slightly different score. A lending institution may subscribe to one bureau, two or all three.

Lending institutions find these credit bureau reports necessary in order to gauge a particular risk. Without subscribing to at least one, a lender would have to find some other way of determining a person's credit worthiness. That would be more time consuming and more costly. Getting back to that Mercedes, a person with a credit score of 640 (the highest score is 800) might be approved for the loan, but would have to pay an interest rate of, say, 11.7 percent, while a person with a credit score of 700 might get a much lower interest rate.

(Continued on Page 41)
"Once a person understands how FICO works, it can be extremely beneficial," says Snyder. "Back in 1993, when I was forced to file for bankruptcy, FICO played a large part in my recovery. After I realized how to play the game, within months, my credit scores with the various credit bureaus were above 700."

Snyder says that consumers should be very careful in choosing a lender when borrowing money for any reason. For example, he says that most banks work with all three credit bureaus, but many credit unions do not because they find it too costly. "I prefer to work with a lender that works with all three bureaus it gives a better picture of the range of your credit scores."

Moreover, Snyder maintains that once a consumer obtains his or her credit scores from one or more of the credit bureaus, that person should look carefully for errors. "If there is an error, and it produces a negative result, then the consumer has two options," says Snyder. "One is to try to have the error corrected on his or her own. This can be very time consuming and complex, even though all the credit bureaus now offer their own consumer hotlines to give assistance. The better way is to seek the advice of an attorney who understands FICO and who is better able to substantiate the fact that an error exists."

Snyder says that consumers have to realize that there is "a whole new world out there, and it's all about credit scores." One thing consumers should be careful about is giving permission for credit inquiries, according to Snyder. "Let's say you're at a department store and you're making a purchase. The clerk asks you if you'd like to apply for a credit card for that particular store. You agree and the clerk asks for your Social Security number to run a credit check. That credit inquiry will go on your FICO record and too many inquiries will lower your credit score. Only apply for credit when you really need it. However, pre-approved offers such as with credit cards, do not fall under the category of credit inquiries."

We all know that it's best to pay our bills on time, but Snyder says that's not enough. "Pay your bills at least a week early because it takes time for those payments to be posted. If you pay 'on time,' they may be posted late and that will affect your credit score," he says.

In addition, Snyder advises thinking twice about closing existing accounts. "FICO takes into consideration the length of time you have had credit with a partic-