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Credit Scoring

Answers to your questions

What's In A Scoring Model?

What is a credit score?

A credit score is a number that indicates how likely you are to pay on a loan or credit card as agreed. It is one piece of information lenders use when evaluating your application for credit. Your credit score may be based solely on the information in your file at the credit bureaus. Other scores may be based on a combination of credit bureau data and information you supply on your credit application. The way you have handled credit in the past has a strong link to how you will probably manage credit in the future. "Probably" is the operative word. Credit scores can't predict with certainty how you or anyone else will act. But they do provide a quick, accurate and objective estimate of how likely you are to repay on time and according to terms.

Scoring Facts and Fallacies

FALLACY: With credit scoring, computers are making the actual lending decisions.
FACT: Computers don't make decisions, lenders do. Lenders determine interest rates and credit terms for particular types of loans and other credit products. They use computers to help process your application. The credit score is part of the application processing procedure. Scoring and automation help lenders give you an answer more quickly (and sometimes with less paperwork).

FALLACY: A score is a "grade".
FACT: A credit score is a predictor of future performance, not a judgement of past behavior. This may seem like a subtle distinction, but it helps to clarify what credit scoring does. Scoring allows lenders to identify individuals who are likely to perform well in the future even if their credit information reveals past problems.

FALLACY: A poor score will haunt me forever.
FACT: Just the opposite is true. A score is a "snapshot" of an applicant's potential level of risk at a particular point in time. Scores change with time and with changes in your credit performance. Past credit problems fade as time passes and as recent positive data increases. Lenders obtain new scores just prior to making a decision, so they have the most recent information available.

FALLACY: Credit scoring is unfair to minorities.
FACT: Scoring models do not consider race, nationality, religion or other prohibited factors in a credit score and would in fact be prohibited by law from doing so. The Fair Credit Reporting Act (FCRA) and the Equal Credit Opportunity Act (ECOA) help ensure that lenders rely on "likelihood of repayment" as their chief criterion when granting credit. Credit scoring is a bias-free tool that enables lenders to better forecast an applicant's likelihood of repayment, and to do so fairly - for everyone.

FALLACY: Credit scoring infringes on individuals' privacy.
FACT: Credit scoring evaluates the same information lenders already obtain on applicants. It simply summarizes the relevant data into more usable information - a score. Those in the financial services industry recognize the confidentiality of credit data. The use of scoring has enabled some lenders to require less data on some applicants.

FALLACY: Since credit bureau information has a reputation for being inaccurate, my credit bureau score is likely to be wrong.
FACT: The perception that credit bureau data is often inaccurate is largely undeserved. The majority of credit bureau information is accurate. That's one of the reasons scoring does such a precise job of forecasting repayment.

Even if credit scoring is not used in lending, a credit report error could affect whether or not you get your loan or credit card. Lenders are required to tell you if they consulted your credit report when reviewing your application. If you were denied credit, the lender must tell you why. And you are entitled to a free copy of your credit report. This allows you a chance to correct the error and have your application reconsidered. A lender may also choose to ignore your score when making a decision.

If you discover an error in your credit report, contact the credit bureaus, and make sure they correct the mistake. Your score reflects a balance of many credit-related factors. Changing one item on the report will not necessarily result in a new score. However, once an error is corrected, it's possible that your score may change, so you may want to ask your lender to reconsider your application.

Answers To Your Questions About Credit Scoring

Does credit scoring help me?

Yes. Scoring speeds and simplifies the credit application process. Scores can be delivered electronically in seconds and are easy for lenders to read and interpret. This means quicker answers on credit applications. Because scoring is objective, there is also less chance of lending discrimination. Applications can be evaluated fairly based on factors proven indicative of repayment performance.

Why do lenders use credit scores?

While not all lenders use scores, those who do use scores use them to help make fast, unbiased decisions on which applicants are likely to pay them back and pay them on time. Lenders want to extend credit to people who will repay and avoid lending to those who will not. A scoring model quickly and precisely evaluates your credit history and distills the likelihood that you will repay as agreed into one easy-to-understand number.

Before the widespread use of credit scoring, a loan officer could make only a subjective interpretation of how likely you were to repay as agreed. Personal judgement could (and often did) influence whether or not people got the credit they applied for.

The availability of credit scores has changed that. Scoring models are objective evaluators, a real plus for consumers.

If one lender turned down my request for credit, will all the others?

Not necessarily. If you've ever shopped for a loan, you know that you may qualify at one bank or credit union, yet be turned down somewhere else. Lenders set credit policies for their loan and credit portfolios. They determine the level of risk they can take on for a particular loan product and what interest rate and/or fees to charge to compensate for that risk.

Scores by themselves do not identify individuals as "acceptable" or "unacceptable" customers. They are just one of the factors lenders use when deciding whom to lend to. How big a role the score plays in the final decision depends on the individual lender.

Where do scores come from?

Statistical models located at the major credit bureaus weigh and measure many pieces of information in order to generate a score. A credit score is a composite based on a large number of complex calculations. Scoring models can weigh and balance these varying factors much more quickly and precisely than a human trying to evaluate the same information without the benefit of computerized models.

What's a good score to get?

Sounds like an easy question to answer, but it's not. Individual lending institutions decide for themselves which scores are acceptable and which are not for different types of loan or credit. The score is a number, not a recommendation. The scoring user - the lender - makes the decision. That decision may be to offer people with scores indicating higher risk, a higher interest rate rather than turning them down altogether. Or a lender might decide to lower their interest rate for someone who presents minimal risk.

How can I improve my score?

The key to improving your score is to consistently pay bills on time. Credit scores are based on your general payment "patterns", the mix of credit cards and loans you have, and any indications that you are actively looking for more credit. Your score will improve as you continue to handle your credit obligations responsibly. Think of a score as a "snapshot" of credit risk - it reflects your risk picture at a specific point in time. A snapshot doesn't change, but when you take another one you will probably look a little different. Similarly, when your credit information changes, your score changes to reflect that. That's why lenders obtain your most recent score whenever you apply for credit.

What is my score? And how do I know it's correct?

Your score changes every time information is added to your credit bureau file, so you don't have one single score. Your score may change when you pay a credit card bill, make a loan payment, or open a new line of credit.

Another reason you don't have just one score is that there is a variety of scoring systems in use, and they vary widely in their numbering. A 475 from one type of system may not indicate the same level of risk as a 475 from another system.

You can ask your lender to tell you whether a credit score was used as part of the decision. If you were denied credit, you should be told the reasons for denial (called Adverse Action Notification), so you can understand your own credit risk snapshot.

If you think your credit report contains mistakes that may have affected your credit score, you may be right. Request a copy of your credit report. An error in a credit report may well affect your score. The three major U.S. bureaus - Equifax, TransUnion and Experian - all have procedures in place for correcting information promptly.

How do I obtain a copy of my credit bureau report?

If you're turned down for credit, you are entitled to a free copy of your credit report. Even if you are not turned down, it's a good idea to review your credit report from each bureau before making a major purchase, or at least once a year to make sure the information is correct. Your request for a copy of your credit bureau report will not affect your credit score in any way. Should you find an error in the report, the credit bureau will investigate the item and respond to you within 30 days. Credit bureaus are required by law to follow up on disputes in a timely manner.

Equifax: (800) 685-1111 equifax.com
Experian: (888) 397-3742 experian.com
TransUnion: (800) 916-8800 transunion.com

What's In A Scoring Model?

- Recent payment history
- The amount of credit you have access to and are using
- How long a credit history you have
- Whether you've been shopping for credit
- Notification of collection and public record items such as liens and bankruptcies

What's Not?

By law, lenders - and scoring models - are prohibited from considering factors such as:

- Your race
- Your religion
- Your gender
- Whether you're married, single or divorced
- Where you were born