

Office for Financial Success – Financial Tip of the Week

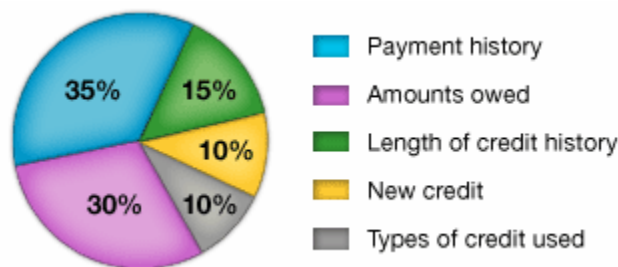
A service of the Personal Financial Planning Department
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University of Missouri-Columbia

CREDIT SCORING

When you apply for credit, lenders want to understand the risks associated with loaning money to you. Credit scores are what most lenders use to determine your credit risk. The most commonly used credit scoring model was created by Fair Isaac Corp. (the FICO Score). Credit bureaus often use different names, such as the Beacon Score or Empirica Score. Each, however, uses the same underlining methods as Fair Isaac. Consumers have three credit scores – one for each of the three credit bureaus (TransUnion, Experian, Equifax). Each is based upon the information that particular agency keeps on file about you. Your score will determine loan terms (interest rates, fees, etc.) as well as how much a lender will offer you. The higher the consumer's credit score, the less risk for a lender (FICO Scores range from 300 to 850). It is possible to have no credit ... Many individuals don't realize that many of the monthly bills paid (i.e., rent, phone, gas, utilities, insurance, etc.) are not reported to credit reporting agencies [unless you miss payments of course!]. Payment history for mortgages, student loans, credit cards, store cards, auto, and other loan and revolving credit accounts are typically reported to credit bureaus on a monthly basis. For a FICO score to be calculated, your credit report must contain at least one of these types of accounts [which has been open for at least six months; also must contain at least one account that has been updated in the past six months]. This ensures there is enough information [and recent information] on which to base a score.

How is the score calculated?

The FICO score is calculated from a lot of data contained in your credit report. The data is most commonly grouped into five categories [as outlined in chart]. The percentages indicate the relative weighting of each area. The following site (<http://www.myfico.com/CreditEducation/WhatsInYourScore.aspx>) will allow you to see what specific items constitute each of the five areas.



While most lenders use credit scoring to make credit granting decisions, each lender is likely to use a 'personalized' strategy to determine how they are going to define a "creditworthy" customer or what an acceptable level of risk is for a given product. There is no universally defined "cut off" where if you're below a certain point you will be denied credit regardless of where you go (hint – I guess you've likely heard the continual talk in the news recently about sub-prime mortgages?). The following MyFICO resource (<http://www.myfico.com/myfico/CreditCentral/LoanRates.asp>) nicely illustrates the financial benefits of having a strong credit score. In addition, more and more people are using credit scoring as a way of evaluating risk in other areas of life – employers, landlords, insurers, utility companies – and the list is growing rapidly.

* It is important to understand that a credit score is a measure of how well you manage debt. Many people are debt-averse [or haven't needed to rely on debt to date] – there is nothing wrong with this; I would never suggest going into debt merely to create a credit score. You will want to ensure that when applying for insurance, a future mortgage, etc. that your lender uses manual underwriting.

Getting your score ...

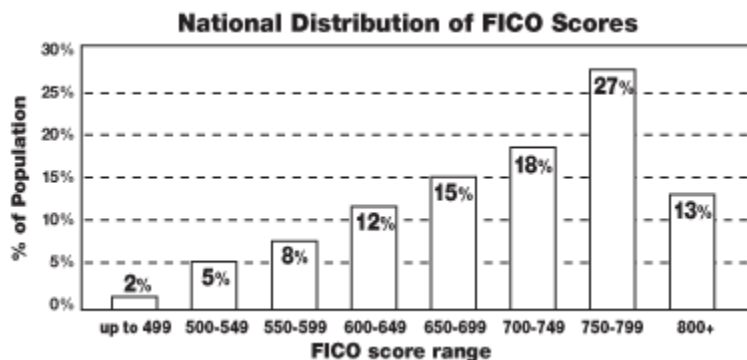
I mentioned last week that the legislation (FACTA) that provides consumers the opportunity to receive a free annual credit report does not provide a free credit score. You have some choices – a simple score estimator (<http://whatsmyscore.org/lesson/estimator/>); also, the e-loan resource I mentioned last week (<https://www.eloan.com/myeloan/viewscore>). If you're interested in purchasing your score, you can go to the following sites – current prices (as of 4/4/07) are listed. Read through the information provided – all of the sites offer additional products (monthly credit monitoring, other 'packaged' services to go with the credit score, etc.)...

- FICO Score (<http://www.myfico.com/Products/FICOOne/Description.aspx>) - \$15.95
o you choose the credit report you want the score based on ...

- Equifax FICO Score and Equifax Credit Report - \$15.95
(https://www.econsumer.equifax.com/consumer/sitepage.ehtml?forward=cps_detail)

- Experian VantageScore - \$5.95
(http://www.experian.com/consumer_online_products/vantage_score.html)

- TransUnion Insurance Score - \$9.95
(<http://www.truecredit.com/insurance?cb=TransUnion>)



Additional Resources.

Credit issues (<http://financialsuccess.missouri.edu/creditissueshome.htm>)

Credit myths (<http://financialsuccess.missouri.edu/tipoftheweek/creditmyths.pdf>)

Credit scores by state (<http://www.nationalscoreindex.com/>)

Credit statistics (<http://www.myfico.com/CreditEducation/AverageStats.aspx>)

Improving your score (<http://www.myfico.com/CreditEducation/ImproveYourScore.aspx>)

MyFICO (<http://www.myfico.com/>)

Ordering free credit report(s) (<http://financialsuccess.missouri.edu/tipoftheweek/freecreditreport.pdf>)

Specialty credit reports (<http://financialsuccess.missouri.edu/tipoftheweek/specialtyreports.pdf>)

Vantage Scoring (<http://financialsuccess.missouri.edu/tipoftheweek/vantagescore.pdf>)

What is not in your score? (<http://www.myfico.com/CreditEducation/WhatsNotInYourScore.aspx>)