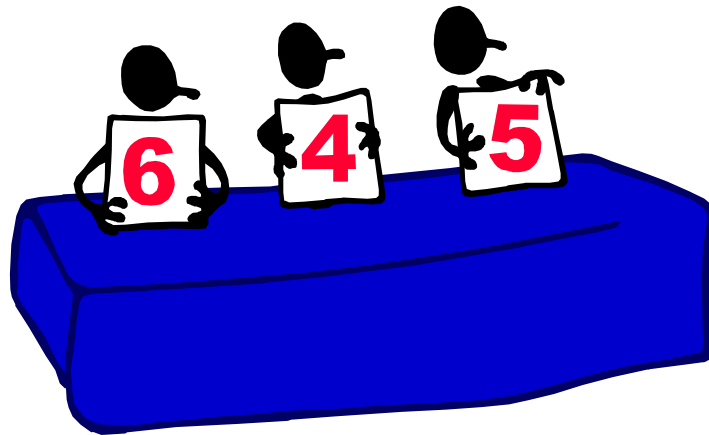


# Credit Score Enhancement

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# FICO Credit Scores



## “How They Really Work”

Please note that I am not an employee of Fair Isaac Company and therefore, I do not have complete knowledge of every detail of FICO credit score design. The information I share with you today comes from public sources and from looking at literally thousands of these credit scores with their associated credit reports in my full-time job as a lending consultant and trainer. I will also point out that...

# Basic Terminology Defined

1. FICO: An acronym that stands for "Fair Isaac Corporation." They are a research firm that has developed the credit scores that are used by most lenders in the U.S.
2. Delinquency: A term used by lenders to reflect a borrower that is late on their loan payment. Lenders track 30-day, 60-day and 90+ day delinquency levels.
3. Trade Line: Lender-speak for an individual loan account that shows up on your credit report.
4. Installment Trade Line: Loans on your credit report that have a specific, fixed number of payments assigned to them (e.g. a car loan, first and second mortgages and personal loans).
5. Revolving Trade Line: Loans on your credit report that do not have a fixed number of payments assigned to them (e.g. credit cards, home equity line-of-credit loans and overdraft lines-of-credit).
6. Underwriting: The process a lender goes through to decide on whether or not to approve a loan request. Many factors, to include your credit score, go in to underwriting a loan request.

# FICO Scores - The Basics

There are three national credit bureaus:

1. Equifax
2. Experian
3. Trans Union

There are many different credit scores available to lenders, but the vast majority of lenders use the following scores:

1. Equifax - Beacon
2. Experian - FICO
3. Trans Union - Empirica

In this seminar you will be learning about these three scores, most commonly referred to as your "FICO" score.

The purpose of these credit scores is to assist a lender in making a credit decision and to predict the likelihood of 90+ day delinquency over the next 24 months. FICO scores range from 300 to 850. The higher the score the better (i.e. a lender views you as lower risk).

## Reasons Why You Want a Good (i.e.High) Credit Score

1. A good credit score significantly increases your chance of a lender approving your loan request. A significant number of banks and credit unions deny loan requests when the borrower has a credit score less than 600. If you cannot get approved for a loan at a bank or credit union, your options get real ugly, real fast.
2. Most lenders today use a credit score to price their loans. If you have a high credit score you are statistically proven to be lower risk and so you will usually receive lower interest rates on your approved loans.
3. Insurance companies use credit scores to evaluate the risk you represent and to set premium rates. They have determined that people that have high credit scores are more likely to take care of their homes and their autos.
4. Employers look at credit reports and credit scores in making hiring decisions.

## Great References to Learn More About Credit Scoring

[www.myfico.com](http://www.myfico.com)

[www.equifax.com](http://www.equifax.com)

[www.consumerfed.org/score](http://www.consumerfed.org/score)

[www.experian.com](http://www.experian.com)

[www.bankrate.com](http://www.bankrate.com)

[www.transunion.com](http://www.transunion.com)

Please note that information contained on these sites is used throughout this presentation.

Effective September 1, 2005, all U.S. residents are able to receive one free credit report from each of the three national credit bureaus once per year. You can get these credit reports at [www.annualcreditreport.com](http://www.annualcreditreport.com).

If you would like to pay to learn your FICO credit scores, I recommend doing so at [www.myfico.com](http://www.myfico.com).

# FICO Score Knowledge Quiz

1. What aspect of your credit history is the most heavily weighted factor in computing a FICO credit score?
2. What aspect of your credit report is the second most heavily weighted factor in computing the score?
3. Is your income a component of the score?



4. Is your length of residence a component of the score?
5. Is your age a component of the score?
6. Is your length of employment a component of the score?
7. Does the score take into account when good or bad credit occurs?
8. If you are married, are the two scores averaged together?
9. How do you improve your score?

# FICO Scores - General Information

## National Distribution of FICO Scores

800 & Above:	11%
750 - 799:	28%
700 - 749:	19%
650 - 699:	16%
600 - 649:	12%
550 - 599:	8%
500 - 549:	5%
Up to 499:	1%

## Score Composition

Payment History	35%
Amount you Owe (Capacity)	30%
Length of Credit History	15%
Types of Credit	10%
New Credit	<u>10%</u>
Total	100%

# FICO Credit Scores

All told there are about 50 different characteristics that are weighed in the FICO scoring models. The credit bureaus will not tell us all of the characteristics and their assigned weights. However, Trans Union has shown us five of their characteristics on the following table and the weights assigned to each characteristic.

EMPIRICA SCORECARD

Characteristic:	Attributes	Points
# bankcard trade lines	0	12 ←
	1	22
	2	30
	3	40
	4	45
	5 or more	50 ←
# finance trade lines	0	75 ←
	1	55
	2	40
	3	35
	4+	20 ←
# months in file	<12	12 ←
	12 - 23	35
	24 - 47	60
	48+	65 ←
# months since most recent bankcard opening	No bankcard	32
	bankcard, but no open date	32
	0 - 5	20 ←
	6 - 11	25
	12 - 17	30
	18 - 23	38
	24 - 35	45
	36+	50 ←
# months since the most recent derogatory public record	No public record	75 ←
	0-5	10 ←
	6 - 11	15
	12 - 23	25
	24 - 47	38
	48+	50

# What a FICO Score Ignores

- Your race, color, religion, age, national origin, sex and marital status.
- Where you live, your salary, occupation, title, employer, date employed or employment history.
- Any interest rate being charged on any loan on your credit report.
- Whether or not you are participating in a credit counseling service of any kind.
- Certain types of inquiries. The score does not count "consumer-initiated" inquiries - requests you have made for your credit report in order to check its validity. It also does not count "soft" inquiries such as promotional inquiries made by lenders in order to make you a pre-approved credit offer; or administrative inquiries made by lenders to review your account with them. Inquiries that are marked as coming from employers are also ignored.

"You may have heard that a large number of inquiries can have a negative impact on your credit score, but you are probably OK. **The vast majority of inquiries are ignored by the FICO scoring models.** They are not the steak in the steak dinner. For instance, the model has a buffer period that ignores inquiries within 30 days of getting a mortgage or a car loan. It also counts two or more "hard" inquiries in the same 14-day period as just one inquiry. **You could have 30 auto or mortgage inquiries in a two week period of time and it only counts as one.**"

Hard inquiries are tracked on the credit report for 24 months, but only the inquiries from the most recent 12 months are included in the FICO score calculation.

# How Important is Capacity of Credit Cards?

Why is capacity on revolving lines so important to your FICO score? Because the FICO model knows that the majority of Americans who go bankrupt run up their credit cards to the limits before filing.

I will illustrate how a FICO score is affected by a person that decides to consolidate their credit cards and close out their accounts - thereby hoping to improve their credit score:

<u>Before</u>	<u>After</u>
Eight credit cards	Two credit cards
\$40,000 in limits	\$10,000 in limits
\$10,000 in balances	\$10,000 in balances
75% available capacity	0% available capacity

In this example, the person is no further in debt, yet their credit score will drop dramatically because they have removed all of their available capacity on their credit cards.

If you reduce the available capacity on your revolving lines of credit you lower your credit score. Therefore, I do not recommend that you close out your credit card accounts. If you are closing out your credit cards for non-use you are reducing your available capacity - and your own credit score!

## How Lenders Use FICO Scores

FICO Credit Score	Credit Tier	Sample Auto Loan Rates				
		Up to 35 Mo	36 to 47 Mo	48 to 59 Mo	60 to 71 Mo	72 to 84 Mo
730 +	1 or A+	4.00%	4.25%	4.50%	4.75%	5.25%
680 - 729	2 or A	4.25%	4.50%	4.75%	5.00%	6.00%
640 - 679	3 or B	5.50%	5.75%	6.00%	6.25%	7.25%
600 - 639	4 or C	8.50%	8.75%	9.00%	9.25%	10.25%
550 - 599	5 or D	12.00%	12.25%	12.50%	12.75%	n/a
549 or less	6 or E	16.00%	16.25%	16.50%	16.75%	n/a

Credit Score	Credit Tier	Sample Home Equity Line-of-Credit Rates		
		Up to 80% LTV	Up to 90% LTV	Up to 100% LTV
730 +	1 or A+	Prime - .50%	Add 1%	Add 2%
680 - 729	2 or A	Prime	Add 1%	Add 2%
640 - 679	3 or B	Prime + 1.0%	Add 1%	Add 2%
600 - 639	4 or C	Prime + 2.0%	Add 1%	Add 2%
550 - 599	5 or D	Prime + 3.0%	Add 1%	Add 2%
549 or less	6 or E	Prime + 4.0%	Add 1%	Add 2%

Please note: These rates are not your credit union's rates.  
The Prime lending rate is currently 6.50%.

## How Lenders Use FICO Scores (Cont.)

Credit Score	Credit Tier	Sample Credit Card Rates	
		Card Type	Rate
730 +	1 or A+	Platinum	Prime + 3%
680 - 729	2 or A	Platinum	Prime + 3%
640 - 679	3 or B	Gold	Prime + 6%
600 - 639	4 or C	Gold	Prime + 6%
550 - 599	5 or D	Classic	Prime + 13%
549 or less	6 or E	Classic	Prime + 13%

Credit Score	Credit Tier	Sample First Mortgage Rates
730 +	1 or A+	5.580%
680 - 719	2 or A	5.704%
640 - 679	3 or B	6.240%
600 - 639	4 or C	7.386%
550 - 599	5 or D	8.590%
549 or less	6 or E	9.589%

# FICO Score Conclusions

1. It is very difficult to score above 700 with a currently delinquent account.
2. To score above 730, maintain a high level of capacity on your revolving accounts and have no current or past public records and delinquent accounts.
3. It almost always takes little or no capacity and current delinquencies to score less than 500.
4. Scores in the 600s usually can be described in one of two ways:
  - You are paying well (on time), but you have only average capacity, or
  - You are paying OK (occasional sloppiness), but you have good capacity.

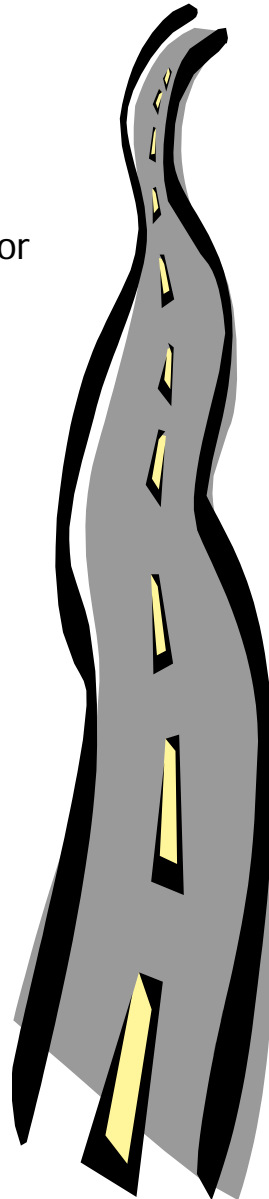
# Understanding the Crossroads that Lead to Your Credit Score

## What makes up the score?

- 35% = Payment History
- 30% = Capacity (Capacity is King)
- 15% = Length of Credit
- 10% = The Search & Acquisition for New Credit
- 10% = Type of Credit

## What actions will hurt the score?

- Missing payments (irregardless of \$ amounts...It will take time to recover from one late pay).
- Credit cards at capacity (i.e. maxing out credit cards).
- Closing credit cards out (this lowers available capacity).
- Opening up numerous trades in a short time period.
- Having more revolving loans in relation to installment loans.
- Loans at finance companies.



## What does not affect your score?

- Debt ratios
- Income
- Length of residence
- Length of employment

## Approximate Credit Weight for each Year

- 40% = current to 12 months
- 30% = 13-24 months
- 20% = 25-36 months
- 10% = 37+ months

## How to improve the score?

- Pay down on credit cards.
- Do not close credit cards. because capacity will decrease
- Continue to make payments on time (old late pays will become less significant with time).
- Slow down getting new loans.
- Acquire a solid credit history with years of experience.
- Move revolving debt to installment debt.

# What Does all of this Mean for You?

## Sample \$25,000, 60-Month New Car Loan Purchase

<u>Credit Tier</u>	<u>APR</u>	<u>Monthly Pmt</u>	<u>Total Interest Paid</u>
A+	5.282%	\$475	\$3,501
A	6.058%	\$484	\$4,040
B	8.491%	\$513	\$5,768
C	11.256%	\$547	\$7,805
D	15.258%	\$598	\$10,888
E	16.594%	\$616	\$11,952

A+ to E-paper difference in payment: \$141 a month!  
A+ to E-paper difference in total interest paid: \$8,451!!

## Sample \$170,000, 30-Year First Mortgage Loan

<u>Credit Tier</u>	<u>APR</u>	<u>Monthly Pmt</u>	<u>Total Interest Paid</u>
A+	5.580%	\$974	\$180,565
A	5.704%	\$987	\$185,360
B	6.240%	\$1046	\$206,421
C	7.386%	\$1175	\$253,152
D	8.590%	\$1318	\$304,484
E	9.589%	\$1441	\$348,582

A+ to E-paper difference in payment: \$467 a month!  
A+ to E-paper difference in total interest paid: \$168,017!!

## **A Nickel's Worth of Free Advice...**

1. Be very careful that your level of unsecured debt (i.e. higher-rate personal loans and credit cards) does not get away from you.
2. Don't load up on multiple new loans in a short period of time (i.e. escalating debt).
3. Don't get in to a situation where you are "robbing Peter to pay Paul" on your credit cards. In other words, don't "max" them out.
4. Do your absolute best to resist the temptation to "solve" your financial problems by filing for bankruptcy.

### **And Finally...**

**"Those that understand interest earn it.  
Those who don't, pay it!"**