

New credit-score method forgiving

By David Migoya

The Denver Post

(The Denver Post)

A glitch on Carl Walker's credit report — an uncollected medical bill that wasn't even his — popped up just 10 days before he and his wife, Rebecca, were to close on their first home.

Several weeks and headaches later, the credit bureaus cleared the problem and Carl, 26, and Rebecca were able to salvage the favorable interest rate they were given for having good credit histories.

But the experience slammed home the importance of having a good credit score. Unfixed, the glitch would have needlessly cost the Walkers three-fourths of an interest point and more than \$100 on each monthly payment for the next 30 years.

"I learned so much about credit scores since then," Rebecca Walker, 29, said of the 2003 experience.

"Back in the day, the only important thing seemed to be not paying any interest on your cards for a good score. That wasn't true."

And things are about to change yet again.

Fair Isaacs Co. of Minneapolis, the company that devised the complex algorithm that computes the credit score used by 90 percent of the nation's top 100 banks, has tweaked it so that bad credit risks will be more broadly separated from the good ones.

The fifth generation of the formula comes at a critical time as lenders more closely scrutinize customers for creditworthiness following the collapse of the subprime mortgage sector.

"It predicts the likelihood a person will become 90 days late or more — seriously delinquent — on any credit obligation in the next two years," said Craig Watts, spokesman for Fair Isaacs.

The credit score has become as common as the penny. Everyone has one, and many haven't a clue what to do with it.

Visa USA recently found that two of every five consumers hasn't ever checked their credit score and have no idea if it's good or bad. And just one in five checked it at all last year.

"If the people caught up in the subprime fiasco had known their score and what the general lending community thought of them, then they might have been less likely to be

persuaded by the unethical lenders pressing for them to sign," Watts said. "It's good to know before you look for a loan because you'll know where you stand."

Lowdown on scores

Your credit score is relied on more and more in the granting and pricing of credit, insurance, cellphones, employment and utilities.

The formula provides a score ranging from 300 to 850, with the top score "as rare as chicken teeth," said Watts.

The median score nationally — where half the nation falls below and half above — is 725 with 13 percent of consumers scoring higher than 800. Three-quarters of Americans score at least 650.

How important is a good score? Someone in Colorado with a 750 score will pay \$771 on a \$25,000 auto loan while someone with a 650 score will pay \$822 a month, according to myFICO.com, which tracks interest rates daily for each state.

Under the new scoring model, called FICO 08, consumers will see their scores change, some going up, others down.

In part, it's because the new formula, which is expected to see widespread use by summertime, will be more sensitive. It will grant some forgiveness for the financial stumbles that occur in life, meaning once-unfavorable delinquencies might not translate into years plagued by high interest rates.

In turn, the updated formula may penalize those who have tied up most of their available credit, even if their credit histories are spotless.

"If you stumble once, FICO will be more tolerant of that if it's balanced with other accounts showing a clean bill of health and good credit management," Watts said.

Also discounted from the revised system are "piggyback" users, who took advantage of a process that allows people with good credit to add authorized users to an account. Previously, the piggyback users improved their own scores as a result.

"The biggest misconception is that scores pay attention to assets. They don't," Watts said. "Only your relationship with creditors is factored."

Getting a good credit score seems easily done, but financial counselors share all-too-common stories of families who fall behind on their debts, then snowball into an inescapable mess.

"Many people wish to know how fast can they raise their score. It's not rocket science," Watts said. "It depends on what's depressing it."

What you can do

If the problem is high balances, then consumers ought to pay down the bills. If it's a poor payment history, that takes a little more time to fade off the report.

FICO suggests three ways to improve: Pay bills on time, pay down high balances, and restrict new accounts to the times you need them.

Consumers should check their credit report annually from all three credit reporting bureaus — Equifax, Trans Union and Experian — and can do that at www.annualcreditreport.com. Finding glitches like the Walkers did can save you hundreds of dollars.

"The first thing I learned in addition to monitoring your report is even if you never use it, having the credit is good," Rebecca Walker said.

Keeping your credit debt to about 25 percent of your available credit is also a good benchmark. Too many inquiries — FICO lumps mortgage or car-loan inquiries into one so you're not dinged too many times while shopping — can be bad.

Inquiries by potential employers or preapproved credit offers, however, are not factored.

Lenders often check scores from all three bureaus because the number differs, based on the information each bureau has gathered. Armed with all three, lenders pick the middle one.

How the new formula works

The new FICO 08 credit-scoring formula takes into account a variety of information that could raise or lower current scores. Here are a couple of scenarios to show the outcome:

Scenario 1: Bill and Jennifer each has had credit for about three years and each has five accounts on a credit report. Their separate credit scores are 665 and neither has any account 90 days or more past due, which is considered seriously delinquent. Under FICO 08, Jennifer's score drops to 645; Bill's rises to 685. Here's why:

Jennifer has few active accounts compared with Bill and has one card that's nearly maxed out. Bill's accounts are all active, are paid on time and do not have high balances compared with their limits.

Scenario 2: Fred and Isabel each have as many as 20 accounts and opened new accounts the past year. They pay on time and each has a FICO score of 725. Under FICO 08, Isabel's score rises to 745; Fred's drops to 705. Here's why:

Isabel has lower balances on her credit cards compared with the cards' limits, and most of her accounts are actively used. A car loan is nearly paid off, showing good credit history.

Fred has high balances on his cards and his auto loan is newer, so the balance hasn't dropped much.

Source: Fair Isaacs Corp.

Improving a credit score

Whether a new or old formula is used to compute your credit score, the ways to improve it remain basically the same:

- Pay bills on time instead of moving balances and playing the revolving credit-card game.
- Get current on overdue accounts. Timely payments are critical to your score.
- Don't use all your available credit. A good ratio is 25 percent of what you have.
- Don't close accounts you're not using unless you really don't need them. It raises your use-to-limit ratio.
- Don't apply for cards you don't need. Too many new-card inquiries can hurt your score. It's fine to check your own score though.
- Check all three credit-bureau reports annually and fix any inaccurate information immediately.

Source: Denver Post research

What's it going to cost?

FICO credit scores play a huge role in determining how much consumers will pay for certain types of credit and loans. Here's a look at what consumers can expect to pay in Colorado for a 30-year fixed-rate mortgage of \$300,000.

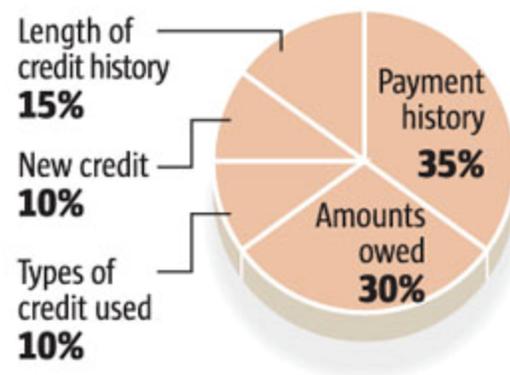
As of Jan. 15

FICO score	APR	Monthly payment
760-850	5.362%	\$1,677
700-759	5.582	1,719
660-699	5.865	1,773
620-659	6.671	1,930
580-619	8.488	2,304
500-579	9.154	2,447

Source: myFICO.com

FICO score formula

Although Fair Isaac will not reveal the details of the complex algorithm used to calculate credit scores, it will say what types of things are factored into it. Here's a rundown.



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