# RHOL Credit Scoring

Creditors have been using credit-scoring systems to determine if an applicant is a good risk for credit for many years. More recently, credit scoring has been used to help creditors evaluate the ability to repay home mortgage loans or rent housing.

Here's how credit scoring works in helping decide who gets credit—and why.

**What is Credit Scoring?**

Credit scoring is a system creditors use to help determine whether to offer credit.

Information about you and your credit experiences, such as your bill-paying history, the number and type of accounts you have, late payments, collection actions, outstanding debt, and the age of your accounts, is collected from your credit application and your credit report. Using a statistical program, creditors compare this information to the credit performance of consumers with similar profiles.

A credit scoring system awards points for each factor that helps predict who is most likely to repay a debt. A total number of points—a credit score—helps predict how creditworthy you are, that is, how likely it is that you will repay a loan and make the payments when due.

Because your credit report is an important part of many credit scoring systems, it is very important to make sure it's accurate before you submit a credit application.

**Why is credit scoring used?**

Credit scoring is based on real data and statistics, so it usually is more reliable than subjective or judgmental methods. It treats all applicants objectively. Judgmental methods typically rely on criteria that are not systematically tested and can vary when applied by different individuals.

**How is credit scoring model developed?**

To develop a model, a creditor selects a random sample of its customers, or a sample of similar customers if their sample is not large enough, and analyzes it statistically to identify characteristics that relate to creditworthiness. Then, each of these factors is assigned a weight based on how strong a predictor it is of who would be a good credit risk. Each creditor may use its own credit scoring model, different scoring models for different types of credit, or a generic model developed by a credit scoring company.

Under the Equal Credit Opportunity Act, a credit scoring system may not use certain characteristics—like race, sex, marital status, national origin, or religion—as factors. However, creditors are allowed to use age in properly designed scoring systems. But any scoring system that includes age must give equal treatment to elderly applicants.

## What can I do to improve my score?

Credit scoring models are complex and often vary among creditors and for different types of credit. If one factor changes, your score may change—but improvement generally depends on how that factor relates to other factors considered by the model. Only the creditor can explain what might improve your score under the particular model used to evaluate your credit application. Nevertheless, scoring models generally evaluate the following types of information in your credit report:

- *Have you paid your bills on time?* Payment history typically is a significant factor. It is likely that your score will be affected negatively if you have pa bills late, had an account referred to collections, or declared bankruptcy, i history is reflected on your credit report.

- *What is your outstanding debt?* Many scoring models evaluate the amount debt you have compared to your credit limits. If the amount you owe is clo to your credit limit, that is likely to have a negative effect on your score.

- *How long is your credit history?* Generally, models consider the length of yo credit track record. An insufficient credit history may have an effect on you score, but that can be offset by other factors, such as timely payments ar low balances.

- *Have you applied for new credit recently?* Many scoring models consider whether you have applied for credit recently by looking at "inquiries" on you credit report when you apply for credit. If you have applied for too many n accounts recently, that may negatively affect your score. However, not all inquiries are counted. Inquiries by creditors who are monitoring your accou or looking at credit reports to make "prescreened" credit offers are not counted.

- *How many and what types of credit accounts do you have?* Although it is generally good to have established credit accounts, too many credit card accounts may have a negative effect on your score. In addition, many mod consider the type of credit accounts you have. For example, under some scoring models, loans from finance companies may negatively affect your credit score.

Scoring models may be based on more than just information in your credit report. For example, the model may consider information from your credit application as well: your job or occupation, length of employment, or whether you own a home.

**To improve your credit score under most models, concentrate on paying your bills on time, paying down outstanding balances, and not taking on new debt. It's likely to take some time to improve your score significantly.**

## How reliable is the credit scoring system?

Credit scoring systems enable creditors to evaluate millions of applicants consistently and impartially on many different characteristics. But to be statistically valid, credit scoring systems must be based on a big enough sample. Remember that these systems generally vary from creditor to creditor.

Although you may think such a system is arbitrary or impersonal, it can help make decisions faster, more accurately, and more impartially than individuals when it is properly designed. And many creditors design their systems so that in marginal cases, applicants whose scores are not high enough to pass easily or are low enough to fail absolutely are referred to a credit manager who decides whether the company or lender will extend credit. This may allow for discussion and negotiation between the credit manager and the consumer.

## What happens if you are denied credit or don't get the terms you want?

If you are denied credit, the Equal Credit Opportunity Act requires that the creditor give you a notice that tells you the specific reasons your application was rejected or the fact that you have the right to learn the reasons if you ask within 60 days. Indefinite and vague reasons for denial are illegal, so ask the creditor to be specific. Acceptable reasons include: "Your income was low" or "You haven’t been employed long enough." Unacceptable reasons include: "You didn’t meet our minimum standards" or "You didn’t receive enough points on our credit scoring system."

If a creditor says you were denied credit because you are too near your credit limits on your charge cards or you have too many credit card accounts, you may want to reapply after paying down your balances or closing some accounts. Credit scoring systems consider updated information and change over time.

Sometimes you can be denied credit because of information from a credit report. If so, the Fair Credit Reporting Act requires the creditor to give you the name, address and phone number of the credit reporting agency that supplied the information. You should contact that agency to find out what your report said. This information is free if you request it within 60 days of being turned down for credit. The credit reporting agency can tell you what’s in your report, but only the creditor can tell you why your application was denied.

If you’ve been denied credit, or didn’t get the rate or credit terms you want, ask the creditor if a credit scoring system was used. If so, ask what characteristics or factors were used in that system, and the best ways to improve your application. If you get credit, ask the creditor whether you are getting the best rate and terms available and, if not, why. If you are not offered the best rate available because of inaccuracies in your credit report, be sure to dispute the inaccurate information in your credit report.

## Where can you get more information?

The Federal Trade Commission publishes a series of free credit-related publications. For a complete list of FTC consumer publications, ask for ***Best Sellers***. Contact:

Consumer Response Center
Federal Trade Commission
Washington, DC 20580
(202) FTC-HELP (382-4357), TDD (202) 326-2502

You also can access their publications online at **www.ftc.gov**.

You can file a complaint online with the FTC at **www.ftc.gov** or by contacting the Consumer Response Center by phone or mail.