Back to Basics: FICO Myths Debunked
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Julie Wooding
Principal Consultant
Scores and Analytics
FICO

Tommy Lee
Principal Scientist
Analytics and Scores Development
FICO
Agenda

▸ FICO Overview
▸ How does a FICO Score impact consumers
▸ How your FICO score is calculated
▸ Credit Myths
▸ FICO Score impact of mortgage remediation actions
  ▸ Simulated impact; Score distribution shifts
▸ Re-building credit
▸ FICO® Score 9
Celebrating 25 Years of Innovation

World’s #1 credit bureau score, the FICO® Score

- 100 billion sold to date
- Powers 10 billion+ decisions a year
- 70,000+ businesses rely on FICO® Scores
- Used by rating agencies and secondary market to improve risk assessment, transparency
- Available in over 20 countries
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How Does a FICO® Score Impact Consumers?

Joe

Meet Joe. Joe makes a purchase with his credit card. Joe’s lender sends Joe his monthly statement. Joe pays his bill on time. Joe’s lender reports to the 3 bureaus that Joe paid his account on time.

Joe’s lender sends Joe his monthly statement

Bank ABC
Joe’s Bill

Amount due: $XX

This record of good payment behavior will help Joe’s credit standing; Joe’s predicted risk level is low. With consistent good behavior, Joe will likely have a favorable FICO® Score.
How Does a FICO® Score Impact Consumers?

Joe wants a new car

Auto dealer sends the loan request to a bank.

The bank will check Joe’s credit file, FICO Score, and other metrics.

The bank evaluates Joe’s risk level and ability to repay the auto loan.

Joe now enjoys a lower “cost of credit” due to his own positive repayment behavior.
How Does a FICO® Score Impact Consumers?

Meet Tom. Tom makes a purchase with his credit card. Tom’s lender sends Tom his monthly statement. Tom does not pay his bill on time.

Tom’s lender reports to the 3 bureaus that Tom has not paid his account on time. This record of delinquent payment behavior will not help Tom’s credit standing; Tom’s predicted risk level is higher. With missed payments and negative behavior, Tom will likely have a lower FICO® Score.
How Does a FICO® Score Impact Consumers?

Tom wants a new car

Auto dealer sends the loan request to a bank.

The bank will check Tom’s credit file, FICO Score, and other metrics.

The bank evaluates Tom’s risk level and ability to repay the auto loan.

The bank decides to approve Tom’s auto loan, but with a higher interest rate, as he is a riskier borrower.

Tom now has a higher “cost of credit” due to his own negative repayment behavior.
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A statistical process

Convert into a numerical score information from:
- Credit applicants
- Existing accountholders

This score is regarded as a measure of the credit risk (i.e., the probability of repayment)
## Predictive Characteristics

<table>
<thead>
<tr>
<th>CONSIDERED</th>
<th>NOT CONSIDERED</th>
</tr>
</thead>
<tbody>
<tr>
<td>✔ Trade lines</td>
<td>✗ Age</td>
</tr>
<tr>
<td>✔ Inquiries</td>
<td>✗ Address</td>
</tr>
<tr>
<td>✔ Collections</td>
<td>✗ Employment</td>
</tr>
<tr>
<td>✔ Public Records</td>
<td>✗ Income</td>
</tr>
<tr>
<td></td>
<td>✗ Gender</td>
</tr>
</tbody>
</table>
Scores are Designed to Rank Order

“Odds quote” based on the general population – not necessarily applicable to any one lender.

Specific lender's applicants will still “rank order”.
Predictive Characteristics

Custom develop final scorecards

Library of 800+ characteristics

Core group of 40 most predictive characteristics

680
Five Categories of FICO® Score Predictive Characteristics

1. Payment History 35%
2. Outstanding Debt 30%
3. Credit History Length 15%
4. Pursuit of New Credit 10%
5. Credit Mix 10%
1. Payment History

Key Factors

► **How recent** is the most recent delinquency, collection or public record item?

► **How severe** was the worst delinquency—30 days, 90 days?

► **How many** credit obligations have been delinquent?
Payment History
Example

Months Since Most Recent Major Delinquency

2. Outstanding Debt

Key Factors

► How much does the consumer owe creditors?
► What percentage of available credit card limits is the consumer using?
► What percentage is outstanding on open installment loans?

2. Outstanding Debt
30%
Outstanding Debt Example

High

Ratio of Total Balances to Total Limits on Revolving Accounts

Low

0-19%  20-39%  40-59%  60-79%  80-99%  100+%  20-39%
3. Credit History Length

Key Factors

► How long have accounts been established—**average** number of months accounts have been open

► New accounts—number of months since most recent account opening
Amount of Credit History

Example

Number of Months Since Oldest Revolving Account Opening

High

Risk

Low

0–23

24–47

48–71

72–119

120+

4. Pursuit of New Credit

Key Factors

► Inquiries: Number of recent inquiries (12 months)

► New accounts—number of trade lines opened in last year

4. Pursuit of New Credit
10%
Pursuit of New Credit

Example

![Chart showing risk and number of inquiries for Young/Thin files vs Mature/Thick files.](chart.png)
Types of Inquiries

- FICO® Scores only consider consumer-initiated inquiries for credit posted in the last 12 months

- FICO® Scores do not consider the following inquiries:
  - Promotional inquiries
  - Account review inquiries
  - Consumer disclosure inquiries
  - Insurance inquiries
  - Employment inquiries
5. Credit Mix

Key Factors

► What is the mix of credit product types?

► Revolving credit—number of bankcard trade lines

► Installment credit—percent of trade lines that are installment loans
Minimum Scoring Criteria

- Not deceased
- One trade line open at least 6 months
- One undisputed trade line updated in last 6 months
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Credit Myths: How to get a high FICO Score

► Canceling credit cards boosts my FICO score
► I can always pay someone to fix or repair my credit
► Paying cash for everything can help a credit rating.
► The best way to improve my FICO score is to pay off all accounts and close them.
► Good credit is tied to how much money a consumer has in the bank.
► Moving credit card balances around will help hide any debt.
► Paying my debts will make my credit report instantly pristine
Credit Myths: What things will hurt my FICO Score

- Credit counseling always destroys my FICO score
- Too many inquiries hurt my FICO score
- Checking my own credit report harms my FICO score
- A charged off 2nd will not affect my FICO score
- Once a delinquent loan balance is paid off, the item is removed from a credit report.
- If I go delinquent, it’s okay if I payoff in full before foreclosure
- A Foreclosure kills my credit vs. a short sale or Deed in Lieu
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Impact on credit: Loss mitigation actions

- A borrower’s FICO® score can be impacted due to loss mitigation actions.
- The impact severity depends on:
  - The borrower’s credit history
  - How the lender reports the action to the credit bureau.
- A borrower with a high FICO score may drop more than 100 points if he is involved with a foreclosure, short sale or deed-in-lieu.
- Foreclosure, short sale and deed-in-lieu impact the FICO score in a similar way because typically in each of these cases the borrower is seriously delinquent.
- A short sale tends to be reported as “settled for less than the full amount due,” “deed-in-lieu of foreclosure,” or “charge-off” which are considered negatively by the FICO® score.
- The impact of a forbearance or repayment plan depends on how the servicer reports to the credit bureaus. If reported as “paying under a partial payment agreement,” it could have a negative impact on a borrower’s FICO score.
Simulated Impact to FICO Score

<table>
<thead>
<tr>
<th>Event</th>
<th>Consumer A</th>
<th>Consumer B</th>
<th>Consumer C</th>
<th>Consumer D</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starting FICO Score</td>
<td>680</td>
<td>720</td>
<td>780</td>
<td>820</td>
</tr>
<tr>
<td>Score after the following actions were taken:</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>30-days late on mortgage</td>
<td>600-620</td>
<td>630-650</td>
<td>670-690</td>
<td>710-730</td>
</tr>
<tr>
<td>60-days late on mortgage</td>
<td>600-620</td>
<td>610-630</td>
<td>650-670</td>
<td>665-685</td>
</tr>
<tr>
<td>90-days late on mortgage</td>
<td>600-620</td>
<td>610-630</td>
<td>650-670</td>
<td>665-685</td>
</tr>
<tr>
<td>Short Sale/ Deed-in-lieu/ settlement (with no deficiency balance)</td>
<td>610-630</td>
<td>605-625</td>
<td>655-675</td>
<td>660-680</td>
</tr>
<tr>
<td>Short Sale (with deficiency balance)</td>
<td>575-595</td>
<td>570-590</td>
<td>620-640</td>
<td>625-645</td>
</tr>
<tr>
<td>Foreclosure</td>
<td>575-595</td>
<td>570-590</td>
<td>620-640</td>
<td>625-645</td>
</tr>
<tr>
<td>Bankruptcy</td>
<td>530-550</td>
<td>525-545</td>
<td>540-560</td>
<td>550-570</td>
</tr>
</tbody>
</table>

Note: Simulation assumes all else held constant on the consumer credit file
# Time to Recover FICO Score Simulation

<table>
<thead>
<tr>
<th>Consumer A</th>
<th>Consumer B</th>
<th>Consumer C</th>
<th>Consumer D</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starting FICO Score</td>
<td>680</td>
<td>720</td>
<td>780</td>
</tr>
</tbody>
</table>

### Time for score to recover from the following actions:

<table>
<thead>
<tr>
<th>Action</th>
<th>Consumer A</th>
<th>Consumer B</th>
<th>Consumer C</th>
<th>Consumer D</th>
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</thead>
<tbody>
<tr>
<td>30-days late on mortgage</td>
<td>~9 months</td>
<td>~2.5 years</td>
<td>~3 years</td>
<td>~7 years</td>
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<tr>
<td>60-days late on mortgage</td>
<td>~9 months</td>
<td>~2.5 years</td>
<td>~3 years</td>
<td>~7 years</td>
</tr>
<tr>
<td>90-days late on mortgage</td>
<td>~9 months</td>
<td>~3 years</td>
<td>~7 years</td>
<td>~7 years</td>
</tr>
<tr>
<td>Short Sale/ Deed-in-lieu/ settlement (with no deficiency balance)</td>
<td>~3 years</td>
<td>~7 years</td>
<td>~7 years</td>
<td>~7 years</td>
</tr>
<tr>
<td>Short Sale (with deficiency balance)</td>
<td>~3 years</td>
<td>~7 years</td>
<td>~7 years</td>
<td>~7 years</td>
</tr>
<tr>
<td>Foreclosure</td>
<td>~3 years</td>
<td>~7 years</td>
<td>~7 years</td>
<td>~7 years</td>
</tr>
<tr>
<td>Bankruptcy</td>
<td>~5 years</td>
<td>~7-10 years</td>
<td>~7-10 years</td>
<td>~7-10 years</td>
</tr>
</tbody>
</table>

Note: Simulation assumes all else held constant on the consumer credit file
Short Sale – Score Distribution Over Time

Score Distribution
Short Sale (Account Paid for Less than Full Balance)

FICO® 8 Score

October 2009  October 2010  April 2012
Loan Modification (Government) – Score Distribution Over Time

Score Distribution
Loan Modified Under a Federal Government Plan

- October 2009
- October 2010
- April 2012

FICO® 8 Score

<table>
<thead>
<tr>
<th>Score Range</th>
<th>October 2009</th>
<th>October 2010</th>
<th>April 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>300-499</td>
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<td></td>
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<tr>
<td>500-519</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>520-539</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>540-559</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>560-579</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>580-599</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>600-619</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>620-639</td>
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<td></td>
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<tr>
<td>640-659</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>660-679</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>680-699</td>
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<tr>
<td>700-719</td>
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</tr>
<tr>
<td>720-739</td>
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<td></td>
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<tr>
<td>740-759</td>
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<tr>
<td>760-779</td>
<td></td>
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<td></td>
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<tr>
<td>780-799</td>
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<tr>
<td>800-819</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>820-850</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
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How Can You Rebuild Your Credit?

► **Check Your Credit Report** – request a free copy of your credit report at AnnualCreditReport.com and check it for errors. Your credit report contains the data used to calculate your score and it may contain errors. In particular, check to make sure that there are no late payments incorrectly listed for any of your accounts and that the amounts owed for each of your open accounts is correct. If you find errors on any of your reports, dispute them with the credit bureau and reporting entity.

► **Set up Payment Reminders** – Making your credit payments on time is one of the biggest contributing factors to your credit score. You could also consider enrolling in automatic payments through your credit card and loan providers to have payments automatically debited from your bank account.

► **Reduce the Amount of Debt You Owe** – Come up with a payment plan that puts most of your available budget for debt payments towards the highest interest cards first, while maintaining minimum payments on your other accounts.
FICO® Score Tips

► Pay your bills on time
► If you have missed a payment, get current and stay current
► Be aware that paying off a collection account or closing an account with previous missed payments will not remove it from your credit report
► If you have having trouble making payments, contact your lender or a qualified credit counselor
► Keep balances low on credit cards
► Pay off debt rather than moving it around
► Don’t close unused credit cards in an attempt to raise your score
► Don’t open a number of new trade lines in an attempt to raise your score
► If you have been managing credit for a short time avoid opening up a lot of credit at one time
► Avoid credit repair agencies that charge a fee to improve your score
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Numerous changes have occurred since the previous FICO® Score was developed

- Mortgage crisis and the ensuing great recession
- Fewer new accounts are being opened
  - 23% decrease in consumers with new account openings
- Consumers are seeking credit less often
  - 16% decrease in consumers with recent inquiries
- Recent development sample revealed 31% drop in the proportion of origination bads relative to all bads
- Innovative approach required to address these dramatic changes
Revised Treatment of Collection Agency Accounts

► FICO® Score 9 enhancements to the treatment of collection agency accounts:

1. All paid collection agency accounts will now be excluded from the score calculation
2. Unpaid medical collection agency accounts will be assessed differently from unpaid non-medical collection agency accounts

Note: These specific FICO® Score 9 enhancements do not apply to 1st party collection accounts.
Questions?

Resources:
www.myfico.com
www.scoreinfo.org
http://bankinganalyticsblog.fico.com/