"How is this going to impact my credit score?"

VantageScore's Guide to How Common Actions Impact Credit Scores

Contents

The three numbers that make up a credit score have become an obsession to some people. But what's really important is how you manage your credit.

Your credit score is a measure of the likelihood that you will become more than 90 days late on a loan payment. Lenders use your credit score in conjunction with other criteria to help determine whether to approve you for credit - ranging from a mortgage to a credit card, at what interest rate and what terms to offer you. In addition, other businesses – including utilities, landlords and more – may check your credit score to see if you are likely to pay your bills.

In reality, your credit score is an interpretation of the information in your credit files -- a fact that sometimes gets lost when people focus too much on the fluctuations of their score and let their credit score determine their credit behaviors rather than vice versa. The purpose of this paper is to help consumers make good credit decisions and manage credit wisely.

The key is to understand the bigger picture. Every time you use credit, you have an impact on your credit files, whether you are paying for groceries with your credit card or taking advantage of interest-free financing on your living room furniture.

This paper takes a look at two of the most fundamental consumer questions:

- How can I improve my credit score?
- How do certain credit-related activities affect my credit score?

Before we can answer those questions, though, it is important to understand some basics.

VantageScore
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VANTAGESCORE'S GUIDE TO HOW COMMON ACTIONS IMPACT CREDIT SCORES

Credit Files and Their Relationship to Credit Scores

Even the financial gurus on television often make the mistake of not differentiating between credit scores and credit files, which are sometimes referred to as credit reports. Your credit score is a three-digit number derived from a mathematical interpretation of the information in your credit files.

The credit files are maintained by and are available from the three largest national credit reporting companies (CRCs): Equifax, Experian and TransUnion. Most lenders report activity to the three CRCs each month, and credit score models such as the VantageScore® credit score use the information in your credit files to arrive at your credit score.

There are many different credit scores used by lenders. This paper uses VantageScore 4.0, which is the company's most recently introduced credit score model.

Lenders and other institutions typically use a VantageScore credit score or other credit scores -- along with information such as income, total monthly debt payments, down payments and employment status – to make decisions. Taken together, the information helps a lender determine the terms of a loan, which can affect the amount you might pay in interest and finance charges. A higher VantageScore credit score indicates a lower likelihood of risk to lenders, so if you have a higher credit score, you generally can get credit at more competitive rates than you could if your score were lower.

Do Credit Scores Change Often?

The short answer is yes, credit scores do change often.

Your credit score will probably be different each time it is obtained if the information in your credit files has changed since the last time someone asked for your score. The information in your credit file changes when a lender provides an update on the status of one of your credit accounts, such as whether you have made payments on time, how much credit you've used and how much credit you have available.

For example, your credit score goes up as you make on-time payments on a loan or reduce the balance on a credit card. Conversely, your credit score goes down when you make a late payment or increase the balance on your credit cards. Your credit score also changes when you apply for additional credit, take out a new loan or experience a charge-off[1], foreclosure or bankruptcy.

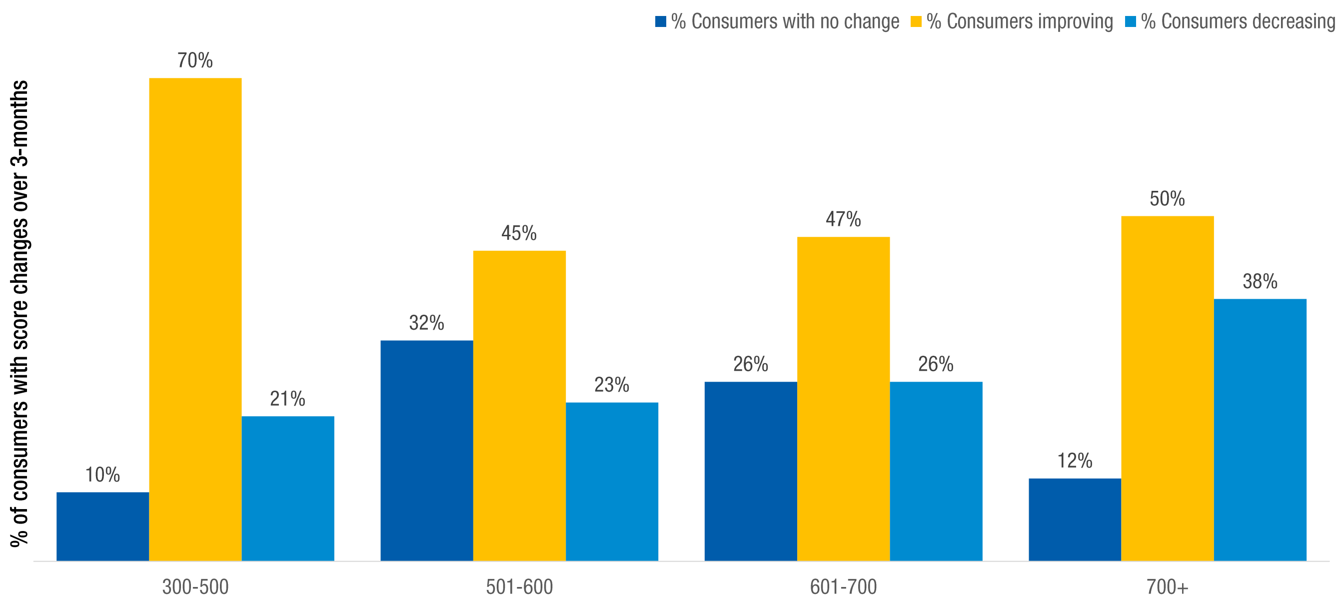
In theory, if you have 10 accounts in your credit file, your score might change 10 times a month if a score is pulled after each single account is reported. There are more than 200 million consumers with credit files in the United States, and approximately 36 billion pieces of credit data are recorded on their credit files every year. That's an average of more than 15 changes to a credit file each month for each consumer. The impact that the data in your credit file has on your credit scores changes over time as well. Negative information becomes less impactful in particular.[2]

Don't be alarmed by this. It's entirely healthy and routine for your credit scores to change slightly. The graphs on the following page show how many consumers experience score changes over a three-month period.

1 *A "charge-off" occurs when a lender doesn't expect a loan to be repaid and takes a loss. The lender reports to the CRCs it has taken a loss, but you still are responsible for paying back the loan.*

2 *More information about the impact of how certain credit activities change over time, is discussed later in this paper.*

Figure 1: Volume of consumers with score change over a three-month period



For consumers with starting scores between 601 and 700, 26.5 percent of consumers exhibited no change in score over a three-month period, while 47 percent experienced a score improvement and 26 percent experienced a score decrease (Figure 1).

Why Do Scores Change?

As mentioned, most adults in the United States have a consumer credit file at one or more of the CRCs. Lenders typically report behavior for each credit account on a monthly basis to one or more of the CRCs.

The impact of each of your singular credit activities on your credit file and credit score varies, but there are generally things that have good or bad consequences. Figure 2 on the following page explains how some credit-related actions and events generally impact credit scores.

Figure 2: Impacts of Various Actions on Credit Scores

Low risk

Action	Lender interpretation…	Score impact
Pays bill on time	Wisely handling debt	Improvement
Low credit utilization	Sufficient access to credit, unlikely to need additional funds	Improvement
Mature accounts	Experienced credit user	Improvement
Uses diverse range of loan products	Experience with different types of repayment requirements	Improvement
Inquiry about new loan	Why the need for credit – exposure or normal expansion?	Small drop
Opens a new loan	Why the need for credit – exposure or normal expansion?	Small drop
New accounts	Will consumer effectively manage new credit?	Small drop
Maxes out credit card (high utilization)	Tipping point: potential for significant exposure	Drop
Pays late – first time	Tipping point: potential for significant exposure	Drop
Pays multiple loans late	All credit at risk	Larger drop
Miss multiple payments on a loan (3 or more)	All credit at risk	Larger drop
Charge off	Default	Major score drop
Foreclosure	Default	Major score drop
Bankruptcy	Default	Maximum score drop, extended time impact

High risk

The actions shaded green for risk, which include paying bills on time and using a variety of different types of credit, obviously signal that you are handling your credit wisely. The actions in the red-shaded risk areas, which include paying multiple loans late and declaring bankruptcy, signal that you are having problems making payments on time (with your credit).

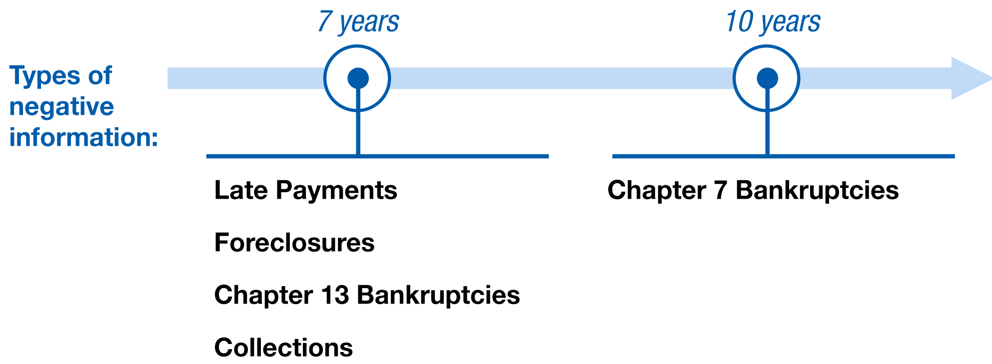
The activities in the yellow-shaded risk area can be entirely appropriate but still can cause your credit score to drop slightly. This is because the millions of transactions and past consumer behaviors used to create and test credit score models show that consumers with these actions on their credit files are riskier than those without them. When risk increases, scores drop, but in the case of the actions in the yellow area, the score drops are minimal.

The small drop caused by the activities in the yellow area can be made up very quickly. For example, your score might go down slightly because an inquiry[3] was reported to the CRCs and you opened a new credit account, but if the CRCs are notified that your payments are on time and your balance is not excessive, your score begins to benefit from the positive information created as a result of the new credit account.

Information, especially negative information, doesn't stay in your credit files forever. Both positive and negative information reported by lenders drops off the file after a set period of time. The table in Figure 3 provides the length of time that certain types of negative credit information remain in your credit files:

3 *Most credit scores accommodate the need for consumers to shop for the best interest rate for a single loan by inquiring with multiple lenders. The VantageScore model interprets all inquiries within a 14-day window as a single inquiry. This is discussed in more detail later in this paper.*

Figure 3: Lengths of Time Negative Information Remains in Your Credit File



But if one of these things has happened to you, don't give up hope! That's because even though this information will stay in your credit files for the length of time indicated in Figure 4 (on the following page) their negative impact on your score diminishes as the information ages. In other words, although a late payment stays in your credit files for seven years, it does not continue to drive down your credit score for the entire period. This is because a credit score will change as the information in credit files becomes older and less impactful to the credit score. In other words, older information is weighted less by credit scores as the data ages.

Here's what you need to know about negative information in your credit files:

1. The negative impact of these undesirable events on your credit score diminishes with each passing month from the time the event occurred.
2. Your score will experience the greatest drop in the first month after the negative event.
3. As time goes by, the event will have less and less impact until at some point it has no impact whatsoever, even though the timeframe in which the event remains in your file hasn't ended. Typically, after two years, most negative items have little impact on your credit score.
4. Of all these events, bankruptcies have the biggest impact on your credit score, causing the largest drops and taking the longest recovery time.
5. With ongoing good credit management, your credit score will improve and offset these events.

What Credit Score Changes Can You Expect from Typical Credit Management Activities?

This question gets to the heart of what is on the minds of many consumers. To illustrate how typical credit management behaviors can impact credit scores, consider the profiles of two typical (yet hypothetical) consumers, Mike and Jeff. *Note that the score impacts are general ranges given the score ranges for Mike and Jeff. The specific score impact will depend on the details of a consumer's unique credit file.*

Mike has a credit score in the Prime credit quality range, 660-740. Prime credit quality consumers typically have several active credit cards (with utilization of roughly 50 percent), an auto loan, a first mortgage and no unpaid agency collections. Utilization is calculated as the sum of the balances on your revolving credit accounts divided by the sum of your credit limits on those accounts. For example, utilization is 50 percent when there are total balances of $2000 on revolving accounts that have a total credit limit of $4000.

Jeff has a score in the Subprime range, between 550 and 600. Subprime credit quality consumers often have a number of installment loans, one or two credit card accounts, unpaid collection accounts and high credit card utilization.

Figure 4 shows the impact that certain common credit-related actions might have on Mike and Jeff's credit scores. Again, it's important to understand that the precise impact on a consumer's score depends on the specific information in his or her credit files. In fact, you will see that some credit actions have a greater negative impact on Mike's credit score than Jeff's. That is because the impact is greater on certain negative activity (i.e., a missed payment) when they occur for the first time. The credit score for a person like Jeff who already missed a number of payments will have already experienced the "first-time" impact. With that in mind, it is important to look at a range of possible score changes for each credit management activity, rather than an exact level of score improvement or drop.

Figure 4-6: Impacts of Actions on Two Credit Score Scenarios

Failure to Make Payments on Time

Mike Prime (660-740)	STARTING SCORE RANGE	Jeff Subprime (550-600)
Score Impacts	Missed Payments	Score Impacts
	Credit Card	
-70 to -90	30 day	-35 to -50
-80 to -100	60 day	-40 to -55
	Car Loan	
-65 to -85	30 day	-40 to -60
-80 to -100	60 day	-40 to -70
	Mortgage	
-85 to -105	30 day	-20 to -40
-100 to -120	60 day	-30 to -50
-90 to -130	**Charge-off**	-45 to -65
-105 to -125	**Foreclosure**	-35 to -65
-100 to -150	**External Collections**	-50 to -80
-200 or more	**Bankruptcy**	-100 or more

For Mike, being 30 days late on a credit card payment can lower his credit score by 70 to 90 points. Being an additional 30 days late lowers his credit score by an additional 10 points to make the total impact of being 60 days late between 80 and 100 points. Because Jeff's credit score is already substantially lower, his original score is reduced by 40 to 55 points if he is 60 days late, which puts him among consumers who are considered very high risk.

TIPS:

- The first missed payment has the largest impact on a credit score. Nevertheless, additional missed payments will continue to drive your score down and make it more difficult to become current. So, if you've missed a payment, try to become current again before your next payment is due.
- Missing a credit card payment has less impact than missing a mortgage payment. This is because credit score models consider late payments on your larger, mortgage secured debts as higher risk than being late on smaller, not secured by mortgage debts such as credit cards.

Accessing New Credit

Mike Prime (660-740)	STARTING SCORE RANGE	Jeff Subprime (550-600)
Score Impacts	Obtaining Credit	Score Impacts
0 to -10	Making an inquiry	0 to -10
0 to +20	Opening a new credit card	0 to +30
0 to -20	Opening a new auto loan	0 to +20
-10 to -30	Opening a new mortgage loan ($200k-$400k)	0 to +50

If a lender runs a credit check and obtains a credit score for either Mike or Jeff to determine their credit risk, an inquiry is reported to the CRCs that could reduce their credit score by up to 10 points. Note that when a new account is approved and opened by a lender, there may be a small score improvement as the lender is signaling confidence in the consumer's ability to successfully manage the loan.

TIPS:

- You should apply for credit only when you need it. If you are approved for credit, then within a short time the impact from making an inquiry will disappear, as the score will quickly improve if you make on-time payments.
- When you do shop for credit, do so within a short period of time. A credit scoring model takes rate shopping into consideration, so if you are seeking credit and if multiple lenders obtain your credit score, their inquiries typically are interpreted only as a single inquiry.*

** The window of time that a credit score uses to account for rate shopping varies. The VantageScore models interpret all inquiries within a 14-day window as a single inquiry.*

Using Revolving Credit

Mike Prime (660-740) Score Impacts	STARTING SCORE RANGE Increasing Credit Card Balances and Utilization	Jeff Subprime (550-600) Score Impacts
-10 to -20	Increase to 70% on one card	-5 to -10
-20 to -30	Increase to 90% on one card	-10 to -30
-30 to -50	Increase to 100% on one card	-30 to -50
-15 to -25	Increase to 70% on ALL cards	-5 to -15
-30 to -45	Increase to 90% on ALL cards	-10 to -40
-40 to -60	Increase to 100% on ALL cards	-35 to -60

If Mike uses up the entire balance on all of his credit cards, it causes his score to drop by 40 to 60 points. Because Jeff's credit score is lower, the impact is less severe, but his score still drops.

TIPS:

- If you must keep a balance on your credit cards, it's best to spread the total credit card balance across multiple credit cards rather than maxing out a single card.
- If you are using credit cards heavily in order to accrue rewards points, some models (like VantageScore 4.0) recognize this as healthy behaviors, while others may penalize you. Always be sure you pay off as much of the balance accrued each month.

Remember again that score impacts are general ranges given the starting score ranges for Mike and Jeff. The specific score impact for each consumer will depend on the details of their unique credit file.

Final Thoughts

The **key** to improving a credit score or maintaining a good score is to practice positive credit behaviors for a period of time -- or better yet, indefinitely. The more evidence of wise credit management in your credit files, the more your credit score improves over time.

You also should plan ahead. If you need to finance the purchase of a car or if you plan to acquire significant levels of credit in the future, keep your credit card balances low now. Don't apply for unnecessary credit and cause inquiries to be reported to your credit files. It's in the months and weeks before you plan to apply for a loan that your credit management activities enable you to get the best terms for the loan.

Lastly, having a good credit score is extremely important, but worrying about whether it goes up and down slightly on a daily or weekly basis is much less important than practicing good credit management and paying attention to the information in your credit files in the long haul. By practicing good credit management, you can ensure that your files are full of information that will keep your credit score high or beat out the information that is affecting your credit score negatively.

Manage your credit wisely, and your credit score will take care of itself.

The VantageScore credit score models are sold and marketed only through individual licensing arrangements with the three major credit reporting companies (CRCs): Equifax, Experian and TransUnion. Lenders and other commercial entities interested in learning more about the VantageScore credit score models, including the VantageScore 4.0 credit score model, may contact one of the following CRCs listed for additional assistance:

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Call 1-888-414-4025
http://VantageScore.com/Experian

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Call 1-866-922-2100
http://VantageScore.com/TransUnion