

FICO reveals how common credit mistakes affect scores

Disclosed for the 1st time, 'damage points' taken off for late payments

By Jeremy M. Simon

Borrowers already knew that late payments hurt their credit scores, but for the first time, they now know the extent of that damage.

Did you max out your credit card? Expect a credit score drop of 10 to 45 points. Declare bankruptcy? Your score will plummet by up to 240 points, and your odds of getting credit will nosedive with it.

The "damage points" data, unveiled Thursday by FICO, are part of the most revealing glimpse into the firm's once-secret -- and still mysterious -- credit scoring model. The new information discloses how many points borrowers' scores will drop when they make the most-common mistakes.

'Help people understand' scores

"I hope this information will help people to better understand FICO scores and the value for them of avoiding credit missteps. It illustrates key points such as the higher your score, the farther it can fall if you stumble," says FICO spokesman Craig Watts. "Getting and maintaining a good score isn't complicated. We all just need to pay our bills on time, keep credit card balances low and take on new debt sparingly. "

The greater transparency about FICO scores is important because American consumers' ability to get credit rises and falls with the number. FICO, the company that pioneered credit scoring, assigns consumers a three-digit number from 300 to 850, depending on how well they handle credit. Other companies also offer scores, but FICO's version is the most widely used by lenders in determining whether a consumer can borrow, and at what rate.

FICO's credit score has been around for decades, but only within the past decade have consumers gradually gained access to theirs. Though the raw numbers can be purchased, how they're figured remains a FICO secret, as closely guarded as the formula for Coca-Cola. Until Thursday, FICO revealed only broad categories of factors influencing the score, but not the number of points at stake for consumers who fail to pay as agreed.



DAMAGE POINTS: HOW MISTAKES AFFECT FICO SCORES

Credit mistake	If your score is 680	If your score is 780
Maxed-out card	Down 10 to 30 pts.	Down 25 to 45 pts.
30-day late payment	Down 60 to 80 pts.	Down 90 to 110 pts.
Debt settlement	Down 45 to 65 pts.	Down 105 to 125 pts.
Foreclosure	Down 85 to 105 pts.	Down 140 to 160 pts.
Bankruptcy	Down 130 to 150 pts.	Down 220 to 240 pts.

Source: FICO

The details

FICO's information shows that bankruptcy does the most serious damage to a credit score (up to 240 points), followed by foreclosure (up to 160 points) while maxing out a credit card has the least numerical impact (as few as 10 points).

Those with good or excellent credit -- so-called prime borrowers -- put more points at risk with each mistake. For example, someone with an average credit score of 680 who pays a bill 30 days late will see a drop of 60 to 80 points. But for someone with an excellent credit score -- 780 -- that same delinquency can send a FICO score tumbling by 90 to 100 points.

The cost in dollars

In order to show just how badly a drop in your FICO score can hurt your wallet, we spoke with members of the home mortgage, auto and credit card lending industries. We presented hypothetical scenarios of a consumer who decided to apply for a \$200,000, 30-year mortgage; a \$20,000, five-year auto loan and a credit card. While all the industry insiders stressed that a FICO score isn't the only factor in determining who gets credit and at what cost (other factors they cited include the borrower's debt-to-income ratio and whether they have already established a relationship with the lender), they were able to provide an idea of what a borrower who had the following credit scores could expect.

Here's some of what they told us:

For a consumer who started with a FICO score of 780:

- Following a 30-day late payment, the consumer's car loan rate would jump nearly 3 percent, costing the borrower \$26 more each month.
- Following a debt settlement, the consumer would pay as much as \$109 more each month on a home mortgage.

For a consumer who started with a FICO score of 680:

- Following a 30-day late payment, the consumer would pay \$41 more each month for a car loan.
- Following a 30-day late payment, the consumer would pay as much as \$95 more each month on a home mortgage.
- Following a debt settlement, the consumer would no longer qualify for a credit card.

THE REAL IMPACT OF CREDIT MISTAKES

Credit mistakes can cost you real money. In the chart below, we spell out just what the impact can be in terms of interest rates -- and dollars -- when you make a credit mistake that takes a bite out of your credit score.

Impact on a consumer with 780 FICO credit score			
	Before mistake	Scenario 1: After debt settlement	Scenario 2: After a 30-day late payment
FICO credit score	780	665	680
Car loan APR	6.99%	9.69%	9.69%
Car loan monthly payment	\$395.93	\$421.90	\$421.90
Mortgage APR	4.875%	5.75%	5.25-5.5%
Mortgage monthly payment	\$1,058.42	\$1,167.15	\$1,135.58
Credit card approved?	Yes	Yes	Yes

Impact on a consumer with 680 FICO credit score			
	Before mistake	Scenario 1: After debt settlement	Scenario 2: After a 30-day late payment
FICO credit score	680	625	610
Car loan APR	9.69%	9.69%	13.79%
Car loan monthly payment	\$421.90	\$421.90	\$463.19
Mortgage APR	5.25-5.5%	5.5-5.75%	5.75-6%
Mortgage monthly payment	\$1,104.41-\$1,135.58	\$1,135.58-\$1,167.15	\$1,167.15-\$1,199.10
Credit card approved?	Yes	No	No

Assumptions: The above numbers assume a 5-year car loan for \$20,000 and a 30-year fixed-rate mortgage for \$200,000. Rate information is based on a sampling of mortgage, auto and credit card lenders around the nation as of Nov. 12, 2009. Scores are based on the FICO range from 300 to 850. A FICO score is just one of many variables that can factor in to an institution's lending decisions.

Some surprised by the details

Consumer advocates say it's important for borrowers to know what can damage their FICO scores. "If they know it in advance, they won't go out and step in a pile of doo-doo. They won't go out and do some of these things," says Linda Sherry, director of national priorities with advocacy group Consumer Action. Even experts found some surprises in today's news. "FICO imposes bigger hits than I would have thought for being maxed out or 30-days late just once,

reinforcing my view that it is a cruder, blunter instrument than they like to claim. Nevertheless, it is a powerful, widely used crude blunt instrument," says Ed Mierzwinski, consumer program director for the U.S. PIRG consumer advocacy group.

Of course, knowing the impact on a FICO score and actually avoiding these mistakes are two separate things: Amid rising unemployment and other daily financial struggles, paying bills and staying on-track financially becomes a much bigger challenge for many borrowers.

"Some of these things are out of their control," Sherry says of consumers.

Additionally, as Weston points out, consumers with identical FICO scores can have different credit histories. That means the same slip-up -- such as maxing out a credit card -- could have different impacts on consumers who have the same FICO score. In the examples they provided, FICO assumed each borrower had several active major credit cards, a mortgage, car loan and student loans.

Sherry acknowledges the benefit of putting a number to a financial blunder. "I don't think we necessarily knew the numbers that a bankruptcy could apply to a credit score," Sherry says.

Helping you make better decisions

While knowing the numbers may not keep you filing for bankruptcy if given no other choice, the information may help you make the best decision when faced with a bad situation.

FICO scores -- and the access to credit they provide -- are a valuable asset to consumers and supply a safety net when incomes are stretched. It's an asset that needs to be protected, Sherry says, even if job loss or catastrophic illness makes bill paying problematic.

"In that period of time, paying down debt is the last thing on your mind. Paying the minimum payment may also be the last thing on your mind, but you'll be doing yourself a big favor if you do," Sherry says.