Consumer Comments on Credit Scoring

https://secure.commentworks.com/FTCCreditScoreStudy/

Bankruptcy weighting

One of the interesting side effects of FICO's risk models is that a chargeoff included in bankruptcy (IIB) is weighted less severely than a chargeoff not IIB. There is plenty of anecdotal evidence that shows that people gain approximately 20-30 FICO points when a chargeoff is changed to an IIB status and loses 20-30 points when that notation vanishes.

What I'd like to know: why is it that I, who may not be able to pay a chargeoff off immediately, am being hit harder for making the choice not to file bankrupcy? I know plenty of people, even those with recent (meaning within the last two years) personal bankruptcy whose FICO scores are above the national mean. Some of them have had more negative items than I, but their scores are significantly higher than mine. While I realize that FICO scoring has to consider the risk of bankruptcy vs. the actuality of it having happened,

As an additional wrinkle, some companies, notably Bank One, refuse to comply with bankruptcy discharges, showing an amount due and owing for accounts IIB and discharged. This is not fair or accurate credit reporting and needs to stop, and not only because it is changing people's FICO scores.

Collection weighting (also includes Question 23 & 24)

On the FICO scoring models, collections are weighted less heavily than chargeoffs. This makes sense: usually there's also a chargeoff tradeline for most collections. However, that said, there are significant side effects.

When a chargeoff is sold to a distressed debt purchaser, it should be reported as a collection. However, frequently this is shown on credit reports as an "open" (meaning revolving), currently delinquent account -- thus, it is weighted more heavily than it should be. If unpaid, sometimes it is "charged off" a second time -- an unfair double-whammy to the consumer's credit score. I maintain that this is a deliberately malicious act. Given that sale of distressed debt is becoming more common, correct reporting needs to be codified into law and policy.

There's an additional, even more important, consequence to a distressed debt purchaser showing the account as an open account rather than a collection account. A consumer's utilization is the percentage of their credit limit that they've used.

Card A $100 of $1000 credit limit
Card B $400 of $1500 credit limit
Card C chargeoff, 0 balance
Debt Purchaser $2000 of $0 credit limit

So, instead of the consumer's utilization appearing to be at 20% ($500 used out of $2500), it appears to be at 100% ($2500 out of $2500). This could cost a consumer significant FICO points because utilization is a huge predictor of risk.

Use of Credit Scores Affecting Consumers with Poor Credit

As a consumer with a poor credit history, I feel qualified to answer this. Essentially, those of us who genuinely didn't understand how credit scoring worked (at all) often made bad choices. As a numbers person, being able to purchase my FICO score has made me able to understand how those choices affected the perception of risk. As a result, in eight months I've gone from having only deeply subprime cards to having significantly better options. For that, I'll always be thankful to Fair Isaac, even though sometimes my score changes on a particular day baffle me.

However, given all the other systemic inaccuracies that especially affect those with poor credit, consumers with poor credit likely frequently have lower FICO scores than they should; however, this is mostly due to underlying reporting errors.

The Effect of Inquiries on Credit Scores

Hard vs. Soft inquiries

Collection agencies and distressed debt purchasers often code their inquiries as consumer-initiated (FCRA 604(c)(3) -- "hard") rather than as an account review (FCRA 609(a)(5) -- "soft"). 604(c)(3) was originally intended to distinguish the reporting of permissible pulls for prescreening from their underlying permissible purpose. However, the language of 604(c)(3) does create a disjoint between permissible use and reporting of said use. Clearly, some permissible uses may not be reported to third parties.

Because of the language of 603(m), some collection agencies have believed that they may report any old inquiry they do as a “hard” inquiry, further distressing the consumer’s credit. However, it seems clear to me that 603(m) is trying to create that exception for permissible use for prescreening and has nothing to do with reporting of inquiries related to account reviews and collections. Since 604(c)(3) creates a disjoint between permissible use and the reporting thereof, and 603(m) only discusses use, inquiries for accounts defined in 603(m)(1) and 603(m)(2) should *not* be reported as hard inquiries.

There are two legal theories I have heard from consumer advocates about why a collection agency may be able to pull a hard inquiry: 1) 603(m)’s language permitting it (which I’ve stated above I don’t believe is the case); 2) “intiated by the consumer” includes any account the consumer opened at any point in the past. For example, a consumer applies for credit. Five years later, they’re late and the creditor pulls a collection inquiry, which is coded as a hard. I don’t believe this was the intent based on the phrasing of 604(c)(3): “a consumer reporting agency shall not furnish to any person a record of inquiries in connection with a credit or insurance transaction that is not initiated by a consumer.” While a consumer’s inaction may have commenced a collection action,

inaction is not synonymous with "initiated." My reading of the above-mentioned phrase might be better read as: "a consumer reporting agency shall not furnish to any person a record of inquiries in connection with a credit or insurance transaction that is not initiated by a consumer *at the time of the inquiry*."

Further, when a distressed debt purchaser buys an account, they frequently pull a consumer's credit right then – and often, that's coded as a hard inquiry. However, even if the consumer had initiated the collection somehow, they clearly did not initiate the sale to a specific distressed debt purchaser. If the account in question is more than seven years old, it seems like this would also be a violation of 605(a)(4). However, it is leverage that is used on old collections since the tradeline per se is too old to report. It's waving the "this consumer is a deadbeat" flag that the collection agency would not otherwise be permitted to wave.

Some data furnishers are coding account reviews as hard, which really annoys cardholders. Sometimes this is done for closed-end installment loans where there is no permissible purpose if the consumer isn't delinquent. As consumers are dinged on scoring systems for seeking new credit, these false and misleading representations harm consumers, but do not appear to be directly actionable by the consumer except in combination with an FDCPA suit or except by suing the credit reporting agency. Instead, data furnishers tell consumers to go pound sand.

Credit Reporting Agencies and Reporting of Inquiries

Additionally, TransUnion and Equifax do not necessarily show all hard inquiries. Some savvy consumers know that TU shows only the hard inquiries that appeared in the last 64 inquiries. Thus, pulling one's credit daily (a good idea if one is in heavy repair process or trying to finance a mortgage) will "bump" off older hard inquiries in approximately two months. Equifax works the same way, but the numbers are a bit different.

At some point, one can have so many soft inquiries that, in order to report them to the consumer, Equifax will actually delete closed, positive tradelines (since all negative tradelines on Equifax have an account status of "open," it's only the positives that are affected) in order to make room for the inquiries. There are several anecdotes that make it appear that said tradelines are deleted in alphabetical order. In February 2005, five of my Equifax tradelines were deleted exactly this way. This kind of stunt does not conform to the "maximum possible accuracy" mandate of the Fair Credit Reporting Act.

Sometimes, Equifax will stop a consumer (or creditors) from pulling a file in (lieu of chopping tradelines) by returning "No file." EQ will tell consumers that they cannot pull their file AT ALL until two years are up. Clearly, this was not the intent of the FCRA, especially since many of these inquiries were only supposed to be reported to the consumer for one year, not two (609(a)(5)).

The other solution TU and EQ have is to split a large file with too many inquiries into smaller files -- this can happen spontaneously. The problem is, when someone requests a consumer's file, one of the split files will be returned randomly. There are also lots of

anecdotes that when a file splits, negative items that were "deleted" or suppressed resurface. Shortly after my positive tradelines were deleted, this happened to me; I now have a second file at Equifax that contains one, previously deleted, negative tradeline that was reinserted without the notice required by the FCRA.

I have had all of the above happen to me personally on Equifax. I have had hard inquiries disappear due to bumping on both Equifax and TransUnion.

Inaccurate Information (Question 23)

As someone who went through a major life trauma and wound up with a lot of negative information on my reports, I've noticed a few things that are detrimental to accurate scoring. When I first started working on my credit in August of last year, I counted 73 major inaccuracies on my credit reports. In total, I had 45 tradelines when I started, so approximately half of my tradelines were reporting with significant inaccuracies.

1) Chargeoffs have been being recorded as CURRENT chargeoffs even after the account was sold, especially by Providian National Bank on Equifax. Equifax also does not report the Date of First Delinquency or the date that negative information is due to expire on one's credit report. Worse, when I disputed it, Providian updated the account to report as a current chargeoff with a zero balance (e.g. in the months after it was sold, which is blatantly inaccurate).

2) Experian also does not report Date of First Delinquency -- you have to call them and ask. Instead, they report "Date of Status" – which may have nothing at all to do with the date the account became delinquent. As a side effect of this, consider this possibility: I have a six-year-old chargeoff on Experian. If I pay it, the Date of Status changes, making it look like a CURRENT chargeoff, which could cost me upwards of 80 FICO points if I paid it. From a FICO scoring perspective, I am therefore better off leaving that bill unpaid until it falls off next year. I don’t believe this quirk of Experian’s reporting is in the country’s best interest. I don’t believe it helps either creditors or consumers accurately evaluate the risk of a consumer’s credit profile.

3) TransUnion only recently started reporting the date that negative information was due to expire. That said, they don't report the date of first delinquency either, thus it's harder to check and verify that items are reporting incorrectly.

4) Data furnishers not having updated in six months to a year, giving a substantially different credit picture about the state of that account.

5) Reporting of late payments that weren’t.

6) Reporting of accounts that weren’t mine (but may have been identity confusion rather than identity theft).

7) Multiple reporting of derogatory accounts that were single accounts (and not just limited to one creditor and one collection agency, either, because that can be accurate reporting).

8) Reporting of lates for up to a year after an installment loan was fully paid.

9) Collection agencies who no longer had the account neglected to delete their tradelines. This accounted for many of the duplicates on my reports.

Systemic Inaccuracies (Question 24)

Not reporting credit limits on revolving accounts is detrimental to consumers generally. Usually, high credit is shown in lieu of a credit limit. Capital One is famous for this; it doesn't report credit limit to any credit reporting agency. Some data furnishers, such as Target, do not show credit limits on Equifax only. This can be remedied by running a card up close to its limit, letting a statement print, then paying it off. However, doing so may invoke universal default clauses on other cards.

The upside is for the consumers with the poorest credit who may go overlimit -- if high credit is being reported in lieu of credit limit, it makes a consumer who has been overlimit appear to be in a better financial position than they actually are. In that case, failing to report the credit limit is beneficial to the consumer but detrimental to other companies making credit-granting decisions based on the information reported.