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Consumers ignore credit scores at their peril

It takes just a small improvement to make a big difference in what you're charged to borrow money. But most pay little attention.

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Consumers could save billions of dollars on credit-card interest each year simply by raising their credit scores by a small amount, but a large majority of Americans remain unclear about how their score is calculated or how it affects them, according to a new survey.

Fewer than a third of all consumers know that their credit score - a numeric value that ranges from 300 to 850 - indicates the risk they'll not repay a loan, a survey for the Consumer Federation of America and Washington Mutual Bank found. A lower credit score indicates a higher level of risk.

Most survey respondents wrongly thought their score reflects their financial resources to repay a loan, the amount of debt they carry or how much they understand consumer credit, the survey found.

Not knowing what a credit score is and what it does could needlessly be costing consumers money, Consumer Federation executive director Stephen Brobeck said.

"The good news is they know more about what will affect their scores," Brobeck said at a news conference Thursday. "The bad news is they don't know what their score means."

Simply increasing their score by 30 points, consumers could reduce credit-card finance charges by about \$105 each year, the survey of 1,000 people found.

If all Americans boosted their scores, they would collectively save nearly \$30 billion in finance fees, the study found, because consumers with the highest scores get the best rates.

The credit score has become as common as the penny. Most everyone has one, and many haven't a clue what to do with it.

And some people probably don't need any reminder that times are tough, according to Vickie Bajtelsmit, chair of Colorado State University's department of finance and real estate.

"The problem lies with the person with a bad credit rating who doesn't know their score, who puts their head in the sand and doesn't know how to fix things," Bajtelsmit said. "The bad ones know it. They don't need someone to tell them their score is a 450. What they don't understand is that they can do something about it."

Credit scores are used by banks and insurance companies to determine rates they offer on loans, credit cards and policies. Scores are also being used more and more by landlords, utilities and employers as a way of determining an applicant's financial worthiness.

But not everyone knows what theirs is. Visa USA last year found that two of every five consumers hadn't ever checked their credit scores and had no idea whether they were good or bad.

"So many of us think we know, but don't," said Kim McGrigg, spokeswoman for Consumer Credit Counseling Services in Denver. "That's because for so long it was a mystery, an unrevealed formula that made up the score. We know so much more now, but that doesn't mean it's not complex. It's not as simple as doing 'x' in order to get 'y' to happen."

The complex algorithm that computes credit scores used by 90 percent of the nation's top 100 banks was tweaked in January so that bad credit risks are more broadly separated from the good ones.

The fifth generation of the formula, devised by Fair Isaacs Co. of Minneapolis, occurred just as lenders were becoming more critical of credit applicants following the collapse of the subprime mortgage sector.

The fastest way to a higher score is to reduce the amount you owe - but not the amount of credit you have. The new FICO score is partly influenced by the amount of unused credit a consumer has.

"Your score is very important as it determines what you'll pay to borrow money," McGrigg said. "If you assume that not using any credit at all will benefit you, it's actually a bigger problem to do that."

The median score nationally - where half the nation falls below and half above - is 725 with 13 percent of consumers scoring higher than 800. Three-quarters of Americans score at least 650, according to FICO.

Credit scores cost about \$15 to obtain. For more information, visit www.myfico.com.

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