# Book Review

# Credit Scores and Credit Reports

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Author: Evan Hendricks
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For professionals who teach or counsel clients about credit use, credit reports, and credit scoring, Evan Hendricks' 390-page tome, *Credit Scores and Credit Reports*, is a valuable reference. Hendricks, the editor/publisher and founder of *Privacy Times*, writes with the authority and accuracy of someone who covers privacy and consumer credit laws for a living. Even experienced credit educators and counselors will learn new information to use personally or to assist clients.

An example is Hendricks' intriguing discussion of missing credit limits on the credit reports of cardholders of Capital One and other companies. Instead of the credit limit being reported, the highest balance ever carried is reported as a de facto "credit limit." This has the effect of lowering some customers' credit scores by making them appear more "maxed out" than they actually are. For example, someone with a $500 credit limit who charges $90 would have an acceptable 18% (90/500) credit utilization ratio. However, if their $500 limit is not reported but, instead their $151 "highest balance" is substituted for it, the credit utilization ratio increases to 60% (90/151), which can cause a person's credit score to plunge. The difference is significant because credit utilization ratios account for 30% of a person's credit score in the Fair Isaac Corporation (FICO) scoring model.

*Credit Scores and Credit Reports* is organized into 23 chapters that are extensively laden with Web links to and quotes from legislation, Congressional debates and testimony, and media reports about credit reports and related topics. Especially interesting are the stories of real people whose lives were disrupted by erroneous credit reports and instances of identity theft. Hendricks draws heavily from testimony provided by victims as well as research conducted by the Federal Reserve Board, the Consumer Federation of America, and other reputable sources.

Credit scores matter! In the "Introduction," Hendricks notes that "the worse your credit score, the more you pay for mortgages, loans, credit cards, and insurance. Conversely, the better your credit score, the more favorable terms you will get on interest rates and premiums." Creditors today can check credit reports and scores inexpensively and routinely review customers' credit reports to spot new problems. Interest rates are then charged accordingly, a practice known as "risk-based pricing." The difference between a 674 and a 619 FICO score on a $150,000, 30-year mortgage is $3,432 per year according to an example provided by Hendricks.

Chapter 1, "Basics of the Credit Score," describes how credit scores came into existence and how they are calculated. Hendricks' definition of a credit score is "a number that reflects your credit worthiness at a given point in time." The five key factors in a FICO credit score are payment history (35%), extent of indebtedness (30%), length of credit history (15%), amount of new credit (10%), and types/variety of credit (10%).

"Credit Scoring: Advanced" is the title of Chapter 2, which discusses cut off credit scores required for various interest rates; the impact of recent events, medical bills, and the timing of credit reports and credit scores; and credit report inquiries. Readers are taught that mortgage and auto-related inquiries made within any 14-day period, more than 30 days, or less than 1 year before calculation of a credit score will count as only one inquiry so as not to

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penalize those “shopping around” for a favorable interest rate. Research findings about the inconsistency of credit scores are also presented.

Chapter 3, “Re-scoring,” describes a professional service available to help consumers improve their credit score. Unfortunately, providers have contracts with the “Big 3” credit reporting agencies that prohibit them from offering their services directly to the public. Instead, rescoring is requested by lenders, on behalf of consumers, if it will result in enough of an improvement to make it worthwhile.

Chapters 4 and 5 discuss how to obtain and read your credit report, respectively. Provisions of the Fair and Accurate Credit Transactions (FACT) Act, with respect to obtaining free annual credit reports, are described in detail. Key contact data for the Annual Credit Report Request Service are www.annualcreditreport.com and 1-877-322-8228 . Account history status codes, “hard” and “soft” inquiries, and possible “secret data” not seen by consumers are described.

The title of Chapter 6 is “Disputing Errors.” It includes recommended steps for disputing credit report errors in order to improve your credit history. Hendricks notes that “the system for correcting inaccuracies does not always work as it should” and recommends one potential shortcut: “Get your credit grantor to tell the credit bureaus that your dispute is valid and the error should be removed immediately. While credit bureaus are often skeptical of consumer disputes, they almost always trust the word of creditors, their paying customers.” Sample dispute letters are provided to assist readers.

Chapter 7, “Identity Theft Basics,” provides a thorough description of steps to take if you become an identity theft victim, as well as dozens of real life stories about the causes and effects of this crime. Chapters 8, 9, 10, 11, and 12 discuss an eclectic mix of credit-related topics: errors due to incorrect or co-mingled credit report data and faulty information search algorithms, credit report reinvestigations, the history of credit bureaus and the national credit reporting agencies (CRAs), credit repair and credit counseling organizations, and debt collection. In Chapter 11, Hendricks describes techniques commonly used by credit repair organizations and enforcement actions against them. He also describes a new type of pro-consumer company that helps people remove errors from their credit reports for a relatively modest fee. Most of its customers come from lender referrals.

Chapters 13, 14, and 15 discuss the impact of credit scores on auto, homeowners, and mortgage insurance, respectively. Hendricks notes that credit scores are used widely in insurance underwriting decisions, particularly by auto insurers. Two plausible explanations for this use are provided: (a) people under stress are more likely to have auto accidents, and (b) those more likely to take risks and get into auto accidents are more likely to experience financial distress than those who are more risk averse. Contrasting views about the use of credit scores in insurance decisions are also presented, as well as a description of insurance underwriting categories and ChoicePoint CLUE (Comprehensive Loss Underwriting Exchange) reports, which provide claims history information for both automobile and homeowners policies. Readers are cautioned about tipping off insurers to potential problems (e.g., mold damage from flooding), which can result in policy cancellation, even if a claim is never filed.

Chapters 16 to 20 describe credit scoring and racial discrimination (16); special credit challenges for minorities, students, seniors, and those experiencing divorce and bankruptcy (17); the process of prescreening and opting out from pre-approved credit offers (18); impermissible access to credit reports (19); and damages caused by faulty credit report data (20). In the latter chapter, court cases related to violations of the Fair Credit Reporting Act (FCRA) are described. The record-to-date indicates cause for concern about federal enforcement of the FCRA. Some judges simply don’t believe that serious damages occur. Hendricks notes, however, that consumers are clearly impacted by inaccurate credit reports in the following ways: (a) unjust denial of credit or insurance, (b) granting of credit or insurance on less favorable terms, (c) time-consuming efforts to correct inaccuracies, and (d) emotional distress and frustration caused by trying to correct errors not of one’s own making.

Perhaps the most interesting chapter is Chapter 21, “The 2003 FACTA Battle.” Unless someone is a beltway insider or full-time consumer or privacy rights advocate, they likely would not know the history of how this legislation came to pass. Key provisions of the FCRA were set to expire on December 31, 2003, so action was needed. The financial services industry wanted to avoid passage of conflicting state laws whereas consumer and privacy groups favored stronger credit reporting legislation. Descriptions of testimony given and alliances and compromises made as the Act was crafted provide valuable insights into the process of passing legislation in the U.S. and the influence of politics.

Chapter 22, "Outer Limits: Missing Limits," describes the problem, described above, of missing credit limits affecting credit utilization ratios and, thus, lowering credit scores. In the "Conclusion" chapter (23), where Hendricks offers his personal opinions about the credit reporting system, he expounds upon this practice, stating "many believe that the advantage to Capital One is that this practice makes its customers look less attractive to other credit card companies who might want to "cherry pick" them through pre-approved credit card offers." He then asks "If lenders can charge more to those with lower credit scores, then will the system have a bias toward lowering scores?" —indeed an important question to ponder. To beat creditors at their own game, Hendricks notes that consumers can make a large one-time purchase that is promptly repaid so that their "highest balance" is close to their true credit limit, thereby lowering their credit utilization ratio.

*Credit Scores and Credit Reports* contains a wealth of information that can help financial practitioners better understand how CRAs operate and problems that their clients are experiencing. For some readers, there might be a bit too much detail, but chapters not of interest can easily be skipped. One minor criticism relates to the organization of the book. There could have been better segues between some of the chapters, or related chapters could have been grouped together into sections. Regardless, the book is a "must-read" for financial counselors and educators. As Hendricks notes in the concluding paragraph, "there is a system out there waiting for you. By understanding how it works, you improve your control over how it portrays you."