

New FICO Score Changes Will Help Lenders But May Further Confuse Members

In response to recent criticism of their scoring system, Fair Isaac recently announced revised FICO Score calculations designed to eliminate loopholes and ensure the score's relevance in changing financial conditions. Lenders of all sizes today are examining their credit evaluation procedures to better anticipate lending risks and improve their decision-making. For credit unions, the question remains how to evaluate and weigh risk while balancing their goal of helping members in need.

Known as FICO 08, the anticipated changes include the following:

- Elimination of authorized user loopholes: these allowed people with bad credit to co-sign cards with consumers with good credit, thereby raising their score
- Reduction of penalties for multiple credit inquiries: this could help consumers who shop for loans with multiple lenders or get pre-qualified
- Adjustment of penalties for late payments: consumers with occasional late payments but on-time loan payments will be penalized less than consumers with recurring late payments.

The changes are expected to go into effect later this year. While it is not known how many members will experience material changes in their FICO score, it is safe to assume there could be a sizable impact based on the FICO score composition for individual credit unions. These changes may further confuse members whose current understanding of their FICO score is fairly low.

Survey Shows Member Understanding of FICO Scores is Low

A recent survey of more than 10,000 online credit union members by the Internet Strategy Consortium revealed that the majority are not familiar with their FICO score and how it is used. Only one-third of online members say they know their FICO score and 25% say they don't know what a FICO score even is! Most importantly, only one-third of members (34%) understand how to improve their FICO score.

Ongoing Education Efforts Needed

Recent media headlines about a credit crisis may cause some members to mistakenly believe they will not be able to qualify for loans and cause members to take steps that could impact their credit scores negatively. For example, concerns about credit card fees may cause some members to close credit card accounts, impacting their FICO scores. Offering online loan pre-approvals and ways for members to investigate their creditworthiness online may help calm these fears. As one member noted:

"Give information on how to better qualify for auto and home loans (refinancing home, etc) especially with the market changing - what credit score you need, length of employment, etc."

Loan denials have such a significant impact on the member relationship that credit unions should reconsider their processes to turn these situations into an opportunity. The problem is two-fold, not only do members not understand why they were denied a loan, but they do not know how to increase their creditworthiness so they can be approved in the future. Giving information on ways the credit union can help them at the time of the loan denial may reinforce the fact that the credit union wants their business in the future.

With the ongoing credit crisis, members are particularly vulnerable to dishonest companies offering to help "fix" their credit scores and restructure debts. The ISC study revealed a real need to improve the awareness of the credit union's existing services.

"I could benefit from a session with someone who could give financial management advice, but at this point I have no money to pay someone for such a session. Specific questions: the best way to dig out of the financial "holes" I am in; What I/we need to do/ change to qualify for refinancing the mortgage and possibly consolidating mortgage, home equity loan, etc."

Both online tools and educational seminars should be used to educate members. Many credit union websites do not even explain the basics about FICO scores and how they are used. There are a number of companies providing financial content, some with financial counseling options. The credit union website should also provide links to reputable resources so members can obtain their FICO scores and credit reports. At a minimum, every credit union should provide a link to the freeannualcreditreport.com website, so members can access their annual free copy.

"Help us consolidate debt with a plan to pay it off and help us repair our credit score that has dropped - some of what we caused, but a lot from errors that we have tried to fix but have been unsuccessful".