**Financial Advisor Magazine**


*July 2011 issue*

# Who Deserves Credit?

*The real estate bust has resulted in advisors helping clients with credit score surprises.*

By Gail Liberman

While great credit scores long have been a given for the well-to-do clients of financial advisors, the real estate bust is leading to a growing number of credit score surprises.

Jeff Rose, a Carbondale, Ill., fee-based CFP licensee, whose clients typically exhibit the Midwest ethic of avoiding credit, recently had a couple with ample retirement savings but no credit history rejected for a loan. Reason: Their lack of credit reduced their credit scores.

Another client's loan interest rate, thanks to a credit score, was a shocker-much higher than expected. And Rose recently helped obtain a secured credit card for a young client getting ready to graduate from college. The student was astounded to discover that although he faithfully obeyed his parents' warnings to avoid credit card debt and he never had a loan delinquency, his credit score was a piddling 570. The top score, by Minneapolis-based Fair Isaac Corp. (FICO), by contrast, is typically 850. "He was blown away!" Rose says.

For Marie DeCaprio, a fee-only financial advisor in Briarcliff Manor, N.Y., the lousy real estate market is leading clients to ask her very specific credit score questions. Generally, the clients are considering a short sale or a strategic default-choosing to walk away from a home. They want to know the impact on credit scores.

FICO scores consider short sales and deeds in lieu of foreclosure as "not paid as agreed" accounts. They have the same impact on a FICO score. A foreclosure can remain on a credit report for seven years, but if other credit obligations remain in good standing, the credit score can begin to rebound in as little as two years. Bankruptcy, as an alternative to foreclosure, may have a greater negative impact on a score due to the fact that it has the ability to affect multiple accounts.

For complex client credit scoring issues, DeCaprio turns to Tracy Becker, whose Tarrytown, N.Y., firm, North Shore Advisory Inc., caters to financial advisors and other professionals. Becker specializes in credit restoration, education and credit monitoring.

Take DeCaprio's client, whose mortgage soon was to convert from interest-only payments to a fully amortized loan. DeCaprio first had the client pull her credit score. Then she and her client immediately followed with a conference call to Becker. "As a financial planner, I lay out the risks to a person's financial situation from every angle," DeCaprio explains.

DeCaprio crunched the numbers to show how the payment change would affect the client, while Becker outlined the impact of a strategic default to the client's credit score. The two identified the risks of different scenarios to the client, but were careful to leave the final decision to the client.

Joel Isaacson, a New York CFP and CPA, says he turned to Becker for a credit monitoring service for clients worried about identity theft. The daily, personalized monitoring service, he says, may cost more than low-cost services offered by credit card companies, but it's offered to his clients at a reduced rate. Isaacson says he'd rather provide his clients with the personalized service of Becker's company, with just "six to ten persons," as opposed to "whoever picks up the phone in India."

Fees for Becker's service can run $400 to "thousands of dollars," depending on what the company does and how bad the client credit is. The final fee, Becker says, is charged only after her success. It may cost $450 to remove one negative item from the reports of the three major credit bureaus-TransUnion, Experian and Equifax, she says. Typically, it's $150 per credit bureau. But correcting multiple problems can add up.

"It's very tough for people to get the best loans at the best rates," Becker says. "It used to be that 700 was a good score. Now 740 is a really good score."

One wealthy client of Becker's, for example, had a tough time getting a loan. His wife had given birth, and the hospital had an outdated insurance plan on file so it kept billing the wrong insurance company. The result: A collection action showed on the client's credit report.

"People think they can [correct] it themselves," Becker says. "But it's not their business." Too often, a client will pay a debt collector to resolve a credit issue. However, once you pay a collection, she warns, it's admitting guilt. "Then we can't remove it [from the credit report]."

Generally, adverse credit information can remain on a credit report for seven years, bankruptcy information for ten years. Information about an unpaid judgment can be reported for seven years after the event took place or according to the state's statute of limitations-whichever is longer.

Although a financial advisor's expertise generally lies in managing money, relying on an outside service for credit issues is controversial. "Credit repair has a long history of abuse and unnecessary costs," says Jon Sheldon, attorney at the National Consumer Law Center, Boston. "A lot of these services do little more than you can do on your own. For example, some repair organizations have form dispute notices that are so standardized that credit reporting agencies ignore them."

The federal Credit Repair Organizations Act aims to protect against credit repair scams. Credit repair organizations must give clients a written statement, called "Consumer Credit File Rights Under State and Federal Law," before the client signs a contract. They must provide a written contract with a client's rights and obligations. Also, a credit repair company cannot:

- Make false claims about services;
- Charge until it has completed promised services; or
- Perform any services until it has a consumer's signature on a written contract and has completed a three-day waiting period. During this period, a client can cancel the contract without paying fees.

The Federal Trade Commission advises that clients make certain a contract specifies:

- The payment terms for service, including the total cost;
- A detailed description of services to be performed;
- How long it will take to achieve the results;
- Any guarantees the company offers; and
- The company's name and business address.

Meanwhile, a client can find specific instructions on improving a credit report at www.ftc.gov/bcp/edu/pubs/consumer/credit/cre03.shtm.

Consumers are entitled to one free copy of a credit report from each of the three major credit bureaus annually at www.annualcreditreport.com. They also can call 877-322-8228.

The chief factor in improving a credit score is paying bills by the due date. A client can set up automatic payments from a bank account to help, suggests the Federal Reserve, but the account must have adequate funds.

Next, the Fed advises, a client should understand how the credit score is determined. After on-time payments, most credit scoring models weigh a client's debt in relation to outstanding credit limits. Becker suggests keeping that ratio at no more than 10%. Credit scores also can be impacted if a credit history is short, or too many accounts have been applied for recently. But a client checking his or her own credit report won't negatively affect a credit score. Nor will creditors checking a report to make prescreened credit offers.

Many credit scoring models weigh the number and type of credit accounts a person has. A mix of installment loans and credit cards could help. Too many finance company accounts or credit cards, though, might hurt.

Becker says that improving a client's credit score is significantly more complex. First, much published information on credit scores applies to mortgages. More banks and insurance companies, weighing whether to issue car insurance, for example, use their own scoring models.

If a client tries to correct a mistake on a credit report, don't be surprised if the handling of the complaint is outsourced. Mistakes concerning cell phone charges can prove particularly difficult. Credit bureaus are intermediaries between the consumer and creditor, Becker explains. Often a creditor just validates the debt, and it stays on a client's record.

Think your client is getting the most accurate credit score at myfico.com? Not necessarily. That score is apt to be different from scores banks use. "Experian would not allow [Fair Isaac Corp.] to send credit scores direct to consumers because FICO wouldn't give them a piece of the profits," Becker notes.

Yet when a client applies for a mortgage, the lender generally pulls FICO scores based on data collected by all three major credit bureaus and takes the middle score. Other companies issue credit scores with numerical ranges that may differ substantially from FICO's 300-850 range. Even Fair Isaac issues several versions of credit scores.

Among the latest credit scoring issues financial advisors need to consider for their clients, Becker notes:

•Activity is critical to building a credit score. Inactivity can reduce scores and cause accounts to close.
• It used to be that if your client shopped 50 lenders for a mortgage, each pulling the client's credit report within 30 days, the client's credit score would drop only once by 2 to 5 points. However, with the economic downturn, big banks cut that 30-day period to 14 days. Thus, if your client's credit report was pulled while he was shopping for a mortgage and a second time, 15 days later at closing, the credit score could drop 4 to 10 points.
• Before opening a business credit card, a business owner should ask if the activity will show up on his or her personal credit report. Otherwise, the new business card could boost the owner's debt-to-credit limit ratio, inadvertently hurting the owner's credit score. Creditor policies vary on this.
• Credit scores are monitored more by business service companies seeking to verify the solvency of a self-employed business owner.
• Is your client opening a new credit card account to take advantage of a 10% discount on a department store purchase? Consider, Becker says, that this simple move may lower a credit score 30 to 60 points. The higher the client's credit score, the more it will drop.
• Although Fair Isaac maintains that its scores don't factor credit counseling, credit counseling can hurt, Becker says. Bankruptcy, she believes, may be a better solution for many. Credit counseling can hurt if the counseling service pays late. It can also hurt if it appears in the "negative information" section of a credit report, which, she notes, is the first item to pop up on TransUnion's credit report-even if a client has no late payments.
• The impact of a loan modification can vary dramatically, Becker says, depending on how the lender chooses to report it to credit bureaus. It may have no impact. However, if the original loan is reported as closed, the score can drop. It can drop even more if a new loan is reported open. Also damaging: if the modification shows up as a partial payment in the negative information portion of a credit report.