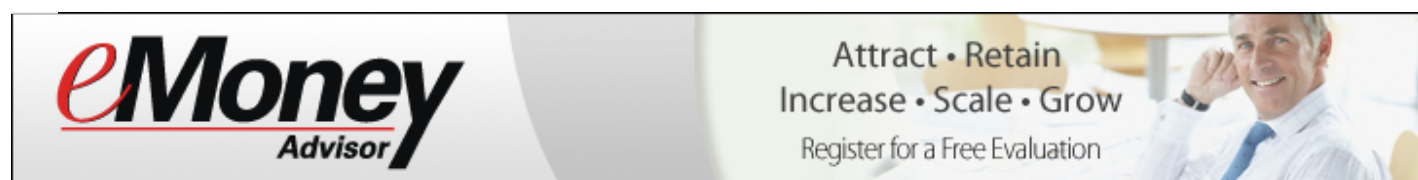


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## Help clients take care of their credit scores

Advisers can help by debunking myths about Fico ratings



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By **Richard J. Koreto**

October 24, 2010 6:01 am ET

In the past, when real estate kept rising, consumers were able to use their homes as de facto piggy banks — despite warnings to the contrary.

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Financial advisers may have had a hard time persuading their clients to take better care of their credit scores. Now, with home prices slashed and lenders anxious, credit management is a new priority.

Advisers can add value by helping clients repair and maintain scores.

**Myth No. 1: There is one absolute credit score — or perhaps three.**

Actually, there are scores of scores. Banks and various agencies may have their own systems with their own scores, but the score everyone talks about is the Fico.

Fair Isaac Corp.'s system is an algorithm. The three national credit bureaus — Equifax Inc., Experian Information Solutions Inc. and Trans Union LLC — gather data and run it through the Fico system.

However, each bureau may have somewhat different data.

“For example, a collection agency may only work with one or two of the three agencies, so only that one has the 'bad' data. A bank will put all three and take the middle one as your score,” said credit consultant Tracy Becker, president and founder of North Shore Advisory Inc.

“Lenders pull three Fico scores because it gives them a full credit history,” said Barry Paperno, consumer operations manager for myfico.com, part of Fico.

He noted that a lender might like a particular bureau. However, Fico designs the scores to be consistent, so a 700 from one is the same as a 700 from the other two.

Clients shouldn't rely on just one score, because banks will be relying on the three Fico scores.

Fortunately, clients don't need to wait until they apply for a mortgage to look at their credit reports. Unfortunately, about 100 companies promise to deliver reports for free, and many are lying to sell expensive and often useless services.

AnnualCreditReport.com is the only site approved by the Federal Trade Commission for annual free reports from all three bureaus.

These reports don't include the actual scores, however, which are available for less than \$20 each directly from the bureaus.

### **Myth No. 2: Earn more money, get a higher score.**

Fico doesn't care how much clients earn. Yes, an individual who makes \$1 million a year is more likely to get a bigger mortgage than someone who makes only \$100,000, but that has nothing to do with creditworthiness.

“There's no secret. Paying balances and keeping balances low is what keeps your credit score high,” said Rod Griffin, director of public education at Experian.

Although Fico's exact algorithm is a secret, the system does reveal the percentages that it assigns to different aspects of each person's financial life: 35% to payment history, 30% to amount owed, 15% to length of credit history, 10% to new credit and 10% to types of credit used. So paying bills on time and not overusing credit lines is more than half the battle.

### **Myth No. 3: It doesn't hurt to apply for credit.**

Consumers who don't manage their inquiries can cause themselves headaches.

“Apply for new credit in moderation and don't seek a lot of credit in a short period,” said TransUnion spokesman Steven Katz.

Such inquiries can put small dings in a credit score.

If your clients are shopping for big-ticket items such as mortgages and auto loans, however, the scoring system gives them a pass: Multiple applications in a two-week period appear as only one inquiry.

But that doesn't mean all credit inquiries are tied together. Consumers who apply for a large line of credit at Macy's to buy new furniture just as they are applying for a mortgage may find that the Macy's inquiry lowers their score far enough so they get a less-than-optimal mortgage rate — or none at all.

### **Myth No. 4: By using all your credit and paying the balance, you show that you are a good risk.**

Consumers who max out their cards hurt their credit scores even if they pay the balance each month on time. It is what credit experts refer to as the utilization ratio — that is, what percent of your available revolving credit



are you using?

Those who max out their cards could see their scores fall if they continually push their balances to the top, Ms. Becker said.

She advises spreading the payments around several cards so none of them has more than 10% of its credit used. This is especially important in the two- to three-month period before applying for a loan.

Mr. Paperno said Fico looks at the total amount on credit cards and at each one individually.

“Basically, the lower, the better. You could have good score even at 30%; use a card with highest amount of credit to maintain a satisfactory ratio,” Mr. Paperno said.

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