

## Reports on credit

and other financial information

# How lenders make — and monitor — credit decisions

### What does a lender look for when making a credit granting decision?

When making a credit granting decision, lenders review credit applications and credit reports primarily in relation to financial risk. If they lend you money, extend you credit, or give you goods and services, will you pay them back?

Lenders may consider your income, how long you've lived at your present address, how long you've worked for the same employer, what kind of assets you have and the balances in your bank accounts. Often, though, the primary resource guiding their decision is your credit history. Here are eight simple rules that will ensure you can get the credit you need:

- **Rule #1:** Establish a credit report. You need a credit history to get new credit. Your credit report acts as your financial references.
- **Rule #2:** Always pay as agreed. Late payments, called delinquencies, will negatively affect your ability to get credit.
- **Rule #3:** Get a credit card. Car loans and mortgages are important, but revolving credit tells more about how you manage credit.
- **Rule #4:** Use caution when closing accounts. Closing an account isn't always a good thing. It can result in the loss of long, positive history, and it can increase your balance-to-limit ratio, making you appear to be an increased credit risk.
- **Rule #5:** Apply for credit judiciously. Don't apply for multiple accounts within a short period of time.
- **Rule #6:** Time is the key. You must allow time to build a credit history and for changes to be updated.
- **Rule #7:** Demonstrate stability. Having stable employment, living at the same address and building other assets over time indicate financial soundness beyond that reflected in your credit history.
- **Rule #8:** Have a plan. Be accountable for your decisions and know how you are going to repay your debts.

Different lenders give more importance to some factors than others. Some lenders also are willing to accept different levels of risk that you may not repay them. Others may charge higher interest rates for higher risk levels.

That's why you might receive a "yes" answer from one lender but a "no" from another.

### What are credit risk scores?

Some lenders make hundreds — even thousands — of credit granting decisions every day. To help them make those decisions faster, more accurately, more economically and more objectively, they utilize a decision-making tool called a credit risk score.




*You fill out a credit application. Later — sometimes seconds, sometimes a week or two — you get your answer, yes or no. This issue of **Reports on Credit** discusses what went into that credit granting decision and answers these important questions:*

- *What does a lender look for when making a credit granting decision?*
- *What are credit risk scores?*
- *What is account monitoring?*
- *What are inquiries?*

Essentially, a credit risk score is a statistical summary of the information in a credit report at the moment it is reviewed. A credit risk score often is calculated as a credit report is delivered electronically from the credit reporting company to your creditor. A credit risk score is not part of your credit history and does not appear on your personal credit report.

There are many sources of credit risk scores. Specialized divisions of some credit reporting companies develop risk scores, and many other independent companies develop credit risk scores for credit grantors. Some credit grantors develop their own computer programs that create credit risk scores.

Different scoring systems also may measure different types of risk, such as bankruptcy, profitability or collectability. In addition, there are scoring systems for different types of lenders or lending, such as auto loans, mortgages, banks and credit unions.

Even if there were only one type of credit risk score, however, not all credit grantors would use it in the same way. Any given risk score — 695, for example — could:

- Result in the extension of credit by one lender and a denial by another
- Meet a particular lender's test at one time and fail sometime later as the lender changes its risk criteria
- Affect the kind of credit — or the rate — offered to a consumer by a particular lender

That's because different credit grantors view the same credit risk score differently. It all depends on their experiences with other consumers scoring in the same range, their marketing plans, their business niches and many other factors.

If your application is declined based on a credit risk score, don't focus on the number, because the numbers vary depending on the scoring system used. Instead, concentrate on the factors that most affected the score. Creditors must provide a list of those factors. You can improve your creditworthiness and your credit risk score for any lender over time by addressing the items on that list.

To better understand how lenders would view your risk level, you can purchase a credit risk score and report that provides not only your credit risk score, but also a thorough report on what in your credit history most affects your creditworthiness. Educational credit risk scores are available from many sources, including [www.experian.com](http://www.experian.com) and [www.nationalscoreindex.com](http://www.nationalscoreindex.com).

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## **What is account monitoring?**

Once lenders make a yes decision, they might review your credit report on a regular basis as they continue to manage their financial risk. This automated process, called account monitoring, scans credit reports for certain risk characteristics as defined by the lender.

Some lenders review their accounts frequently. Others review accounts once a year.

Often, the benefits to you are easy to see. You may receive notice in the mail that your credit limit has been increased — without having to ask.

Account monitoring also allows lenders to reduce losses by decreasing a person's credit limit or charging a higher interest rate when the person shows signs of increasing default risk. When they're successful, their losses are minimized and they don't have to pass the cost of others' bad debts on to you in the form of higher fees and interest rates.

## **What are inquiries?**

The word "inquiry" refers to someone — you or a business — asking to review information in your credit report. At Experian, inquiries remain on a credit report for two years.

Potential lenders will not see inquiries made for the purposes of employment, automated account monitoring, unsolicited credit offers or to request your own report. Such inquiries appear only on your personal credit report and do not affect lending decisions or credit scores.

Inquiries resulting from your application for credit will be shown to lenders and, therefore, can affect credit scores. This is important because such inquiries indicate you've applied for new credit, which could result in additional debt that does not appear as an account entry in your credit report. Therefore, potential lenders may view multiple recent inquiries as a sign that you're beginning to overextend yourself.

Both types of inquiries appear on your personal Experian credit report.



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