

# DCC Dollars & Sense

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## VantageScore

Is FICO's newest challenger as *advantageous* as its name suggests?

### *Special points of interest:*

- How a new credit scoring method could help you.

Your credit score is the single most important factor used by lending institutions in determining credit worthiness: that is, how much credit may be extended and how high the interest rate will be. Though the exact methodology used can be confusing, most people are aware that the higher their credit score, the better the rate will be when they borrow.

Traditionally the score used by Equifax, Experian, and TransUnion, the three largest consumer-reporting agencies, is called the FICO score. This score ranges from 300 to 850, and is calculated using data reported from creditors to the consumer reporting agencies. This data is then run through a formula created by Fair Isaac & Co to create the score. Because each agency may have slightly different data, one's FICO score can vary across the different agencies. As complex as this may already seem, it appears the future of credit scoring is about to become more confusing still, because a new credit scoring system has been cooperatively developed by TransUnion, Experian, and Equifax as a replacement for the FICO score. This new system is called VantageScore.

The reasons behind the development of VantageScore is cloudy; the credit report-

ing agencies say that VantageScore is more, "Intuitive, because it breaks down like an elementary school report card" (Liz Pulliam Weston, MSN Money). For now, we'll focus on why the consumer reporting bureaus would like to get rid of FICO, or at the very least come up with a viable alternate model. Every time a consumer applies for credit at least one of the credit bureaus is queried for a score. The data is processed through the FICO model, and a score is computed. Because Fair Isaac & Co. owns the FICO model; they are paid each time it is used. According to Merrill Lynch, credit scoring is big business: while it comprises 20% of Fair Isaac's revenues, credit scoring accounts for 65% of its operating profits. Credit scoring is a lucrative business. As to be expected, then, the agencies want to get rid of the middleman, and so we have VantageScore. But is it really better?

As mentioned earlier, VantageScore is meant to approximate a letter grade system. Instead of FICO's 300-850 range, VantageScore ranges from 501 to 990. "Scores of 901-990 would be the equivalent of an A, 801-900 a B, 701-800 a C, 601-700 a D, and 501 to 600 an F," writes Michael Singletary, columnist for the Washington Post. This new scoring has already caused added confusion. Singletary explained that one of his readers questioned the new scoring, writing in "It appears now that someone with a credit score of, say, 800 under the current system (FICO), certainly top of the line ... would move from a

## VantageScore Cont.

top rating to average under the new system.” This assumption is incorrect because the score is only meaningful in context. Using the new formula created to compute the VantageScore, the final numerical score would not be the same. Utilizing the same data reported to Equifax, Experian, and TransUnion, which tracks accounts, balances, and payment habits (among other things), someone who scored an 800 under FICO may score a 900 or higher using VantageScore. While the numerical score may change by 100 points or more, a consumer’s actual credit rating should remain about the same.

VantageScore’s Range
901-990 equals "A" credit
801-900 equals "B" credit
701-800 equals "C" credit
601-700 equals "D" credit
501-600 equals "F" credit

One major potential concern for consumers is whether VantageScore will be consistent. While FICO has been in use since 1981, and Fair Isaac has been working on credit scoring since 1958, VantageScore is brand new. As MSN Money’s Liz Pulliam Weston explains, “One of FICO’s big selling points for lenders has been the model’s consistency. Even though the agencies collect and report credit information differently, the same basic FICO model is used at all three to generate comparable scores.” The bureaus have claimed that VantageScore offers this same consistency, but it does not have a proven track record, making lenders cautious about making the leap from FICO. In fact, at this point VantageScore has not been tested against FICO head to head.

Another concern is that VantageScore may make borrowing more difficult. To quote VantageScore’s own website, it offers, “the ability to classify more bad accounts into the

worst-scoring range.” This may be a relief for lenders, because it promises that they will face fewer cases of extending credit to consumers who prove to be bad credit risks. VantageScore also touts its ability to discriminate better than FICO between those with limited credit history and those with longer histories. “If that means the young or others without ‘robust’ histories get better access to credit to buy homes and build businesses, this could be a good thing,” explains MSN Money’s Liz Pulliam Weston, but she cautions, “If it means making credit harder to get for those folks, not so much.” Because the FICO and VantageScore models have not been directly compared it is not clear whether this possible grouping of potentially good credit risks with the bad actually happens, or whether VantageScore is a better agent at distinguishing between robust and short credit histories. However, the fact that these alleged attributes are being promoted as selling points makes it obvious that VantageScore is not designed with the consumer’s happiness as a first priority.

Whether VantageScore will replace FICO as the primary tool used to rate credit-worthiness remains to be seen. This is dependent on whether lenders decide to take a risk, and whether that risk is worth the potential financial incentive of cheaper credit scoring. This does not mean that VantageScore is a bad thing, but rather that it is untested. Therefore, it is more important than ever for consumers to watch their credit reports. While it is always a good idea to check credit reports for accuracy, if VantageScore becomes widely adopted, it will become equally essential to check the actual score as well. Consumers should not compare the FICO score with the VantageScore (if and when VantageScore begins to gain in popularity) directly, but rather see where they rank overall on the individual scales.