Viewpoint: The Potential Dangers of Too Many Credit Inquiries

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By Tracy Becker

Credit inquiries are essential in reviewing loan applications. Bankers who understand how they work can do a much better job helping customers manage their credit scores and in the end get the loans they need. In this age of tight regulation and scrutiny, the impact of credit inquiries can greatly affect interest rates or even whether a loan is approved or disapproved.

Fair Isaac Corp. has long argued that "credit inquiries have a small impact on one's FICO score. For most people, one additional credit inquiry will take less than 5 points off their FICO score," it said. "Much more important factors for your score are how timely you pay your bills and your overall debt burden as indicated on your credit report," Fair Isaac said on its website.

Fair Isaac speaks about the 5 points as if they were insignificant, but 5 points with a 740 or 720 FICO score could equal an extra $100,000 if not $1 million in interest rate costs depending on the size and life of a loan.

Inquiries remain on the credit report for two years. Some types of inquiries will hurt credit scores, while others will not affect them at all.

This seems to be where most confusion comes into play. When a lender pulls credit with the borrower's authorization, this inquiry is called a "hard pull." If a lender or creditor pulls credit without authorization, to consider a consumer for a promotional 2% credit card offer, for example, it is considered a "soft pull" and does not negatively affect the credit score.

But suppose the consumer applies for the promotional 2% credit card? The lender will then undertake a more in-depth review, this time with authorization. This will be considered a hard pull that will reduce the score.

What most bankers may not realize is that each bank chooses what "window" they will use to decide the effect of credit inquiries. The window is defined as the time period the consumer has been allotted to shop for a mortgage loan, car loan or lease, or student loan without each inquiry reducing their credit score. It could be 14 days or 30 days or another time period.

During this window a borrower can have 10, 20 or even 60 inquiries for a particular kind of loan from different lenders and it will only affect the score as if it were one inquiry. This applies only to the three loan types: mortgage, car and student. Each group is considered separately in batches of inquiries.

If the prospective borrower is applying for several types of loans at the same time — a home mortgage, a student loan and a car loan, for example — each type of loan will count as a separate inquiry as they are in separate categories and will not be deemed a single inquiry. Thus, the borrower's credit score can drop by 15 points, not 5.

However once the window is past and more inquiries are made a borrower's score can go down another 5 points and even more if they do not decide to get the loan until much later.

Another way inquiries can drive down a credit score is if they are made for such things as an increase in credit spending limits or to open new credit.

Such credit pulls are never viewed in batches as they are for a mortgage, car loan or student loan, and always reduce a score individually.

A typical example is Ed, with a credit score of 725, who shops for a mortgage at Bank of America on Aug. 1, Wells Fargo on Aug. 3, HSBC on Aug. 12 and M&T on Aug. 16.

All of these banks might have a 14-day window for inquiries to be viewed as one in batches. The three inquiries within the 14-day period only reduce Ed's score by 4 to 5 points, but the inquiry that occurs on the 16th day, past the 14-day window, lowers his score another 4 to 5 points. By the time Ed decides to get the loan two months later, after having his credit pulled, yet again by another lender, his score is down to 710.

At this level, Ed cannot get the type of loan he wants. Before the score reduction Ed's interest rate would have been 4%. Now he is

faced with the choice of paying 1% to 2% more in interest on his $900,000 mortgage, which would equal $800 more a month or $293,084 over the 30-year life of his loan.

Another option would be to buy down the interest rate by paying an extra 2 points to the bank. That would equal an additional $18,000 at closing. The most likely outcome in this economy would be Ed's being turned down completely.

Now, let's say Ed shops for a car at the same time. He goes to Toyota, Lexus and Acura dealers looking for a car loan on Aug. 5, 10 and 14. This will only reduce his score another 4 to 5 points since it is within the 14-day window. But if he also increases his spending limit at Macy's and Lord & Taylor on Aug. 9 and 15 that would possibly reduce his score another 10 points, bringing him down to a 695 score. This would put him in an entirely different category and lessen his chances of reaching his mortgage goal.

Bankers who understand how inquiries can decrease credit scores and how to avoid credit score reductions have the ability to advise their customers accordingly and exert caution themselves when making inquiries on their customers' loan applications.

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