

Understanding the Authorized User Account Issue

Authorized user accounts refer to the practice of “renting” the credit history of a high credit scoring individual to improve one’s own credit rating. An authorized user account can be a spouse added to a credit card, a child or even a close friend.

Recently, another form of authorized user account has become prevalent. Piggybacking is a for-profit form of credit renting, a growing practice that allows people with bad credit to piggyback on the strong payment histories of credit card holders by becoming an authorized user on the account.

PIGGYBACKING

A person with no credit score or a low credit score pays a fee to rent a spot as an authorized user on a stranger’s account. The payment given to the person allowing the piggybacking on his or her credit history depends on the quality of his or her credit line. With their newly improved score, consumers are able to obtain a lower interest rate on mortgages, car loans or personal loans. In some cases, it even helps them get their loan approved instead of denied. Many observers believe that piggybacking could well be contributing to the problems being experienced by some consumers in connection to their subprime or near subprime loans.

The leading “renting company” ICB charges \$900 for the first credit card account, with a discount for additional accounts. The cardholder allowing the piggybacking on his or her credit history can receive \$100 to \$150 per slot, depending on the age and credit limit of each card. ICB pockets the rest.

The effect on a credit score can vary depending on what else is in a client’s report, but one borrowed credit card account can increase a score between 30 and 45 points, two between 60 and 90 points, and five between 150 and 205 points, according to ICB. That’s because the computer program that calculates scores is essentially tricked into believing the credit renter has a better repayment history when it sees the added accounts, and that helps lift the credit score.

So what was once considered something parents could use to help their kids get started with credit, or a mechanism that a spouse could use to help their significant other clean up credit, is now being scrutinized as credit piggybacking.

WHAT IS BEING DONE

Today’s practice of credit piggybacking is currently a loophole in the system. Many high-ranking industry professionals, however, fear that the resulting credit upgrades are major contributors to the increase in foreclosures.

The issue is even catching attention at the state legislation level, with Nevada and New Hampshire already calling the practice “fraudulent.” It is also being called the “first great scam of the new millennium” by financial expert Terry Savage (TheStreet.com).

It is estimated by Fair Isaac that about 30 percent of the 165 million consumers with enough information on their credit reports to have a credit score calculated, have someone on their account as an authorized user. Additionally, Fair Isaac expects as many as 3.3 million people in the United States will effectively lose their credit score because their credit history was established only through authorized user accounts.

This means that some 50 million consumers may be affected by the changes being contemplated— from the millions of spouses listed as an authorized user on credit cards to the one, well publicized case, where a single Discover card had 1,800 authorized user accounts.

The overall consensus taking shape appears to focus on the fact that being an authorized user on someone else's account does not demonstrate an individual's ability to pay their credit obligations. Both the NAMB (National Association of Mortgage Brokers) and the MBA (Mortgage Bankers Association) have taken formal positions against for-profit use of adding an unrelated person as an authorized user to inflate credit ratings. For these reasons, it may not make sense to include authorized user account in the calculation of a credit score.

THERE ARE ALTERNATIVES

There are things that consumers can do to protect themselves and help their credit score under the new system.

Joint Accounts

According to a study by credit.com, 61 percent of those affected by the change are women. The most prevalent example is a married woman who is an authorized user on her husband's accounts. The best option in this case is to convert the account to a joint account. Joint account holders are given the same status on credit reports and in credit scoring. Keep in mind, however, that you will be liable if your co-owner stops paying on time.

Secured Credit Cards

Apply for a secured credit card in your own name. This is a useful strategy for younger consumers but available to nearly everyone. While you do have to deposit upfront money with the lender, these types of accounts are much easier to get than other credit accounts. Your available credit line is usually the amount of your deposit. A good place to start looking for a secured card is at a credit union. Make sure that this account will be reported to the 3 credit bureaus, not all accounts are reported.

Secured Installment Loans

In this case, you deposit money in a savings account or certificate of deposit at a local bank or credit union and receive a consumer installment loan secured by these funds. You then will pay off the loan on a regular schedule. Generally, this is not as favorable as a low-fee secured credit card because you cannot avoid paying interest charges on an installment loan.

Store Credit Cards

Apply for a store card in your own name. Store cards are usually easier to obtain than major credit cards, but they also typically have lower credit line limits, higher interest rates, and often higher required monthly payments. Use them wisely, stay within your limits, and always pay them on time. Note that if the card is issued by a personal finance company, it can hurt your credit score.

Joint Borrower

Someone with strong credit (usually a family member) can refinance an auto loan or a mortgage and list you as a “joint” borrower. In this case you will be liable for the payments if your co-borrower stops paying off the loans. These accounts should appear on your credit reports.

Unsecured Credit Cards

There are certain credit card issuers that specialize in giving unsecured credit cards to applicants with no or poor credit history. These cards have very high fees, high interest rates, and low credit limits. The initial fees are generally a substantial proportion of the credit limit, so this is a very expensive way to obtain a credit history and should be your last resort.

In summary, the credit economy is going back to fundamentals. To keep your credit score high, keep balances low, pay on time every time, keep new accounts to a minimum, and make sure the data in your credit files is accurate and up to date. Avoid applying for many new accounts. It is a good idea to obtain no more than 2 new accounts in a 12-month period.

CreditXpert Inc.

CreditXpert Inc. is the pioneer and premier provider of highly personalized credit management tools—including simulation, optimization and analysis—that help mortgage originators and credit issuers make more informed lending decisions. The CreditXpert® Solution Suite is the sole comprehensive solution capable of identifying opportunities holistically—revealing the best way to manage credit and disclosing the impact of inaccurate information. It provides complete flexibility to match real-world situations so users can achieve the best results. Based on world-class credit scoring, data mining and predictive modeling expertise, the CreditXpert Solution Suite is an advanced hybrid of artificial intelligence, statistical techniques and analytical methods that provides the most accurate predictions and the most compelling results.

CreditXpert’s rich background in credit began in the 1990s with its parent company, the leading developer of credit scoring models. Its scoring models were deployed directly on a credit bureau system and were used by the top three credit card issuers. Building on this expertise, CreditXpert continues to revolutionize the credit economy with innovative software solutions that help clients increase revenue, build stronger customer relationships and retain more customers. For more information about CreditXpert, please visit www.creditxpert.com.

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