

CREDIT PULLS

UNDERSTANDING CREDIT CHECKS

A borrower's credit history can have a significant effect on the type of credit available to them and the cost of that credit. Lenders of all kinds routinely reach out to credit bureaus as part of their assessment of a borrower's ability-to-repay a loan. This process can affect the credit score of the borrower, but the way in which this happens is not well understood. Recognizing the difference between types of engagement with credit bureaus is essential to understanding how they affect borrowers and lenders alike.

CREDIT INQUIRIES

Whenever a lender or other business obtains a credit report about a potential borrower from a credit bureau, the credit bureau is required by law to keep a record of the inquiry. Whenever a borrower asks for a copy of his or her credit report from a credit bureau, the bureau is required to disclose "each person that procured" a credit report about the borrower during the prior year. Generally speaking, credit bureaus are permitted to include the fact of these inquiries in a credit reports. Where a lender obtains credit report information to make an unsolicited "prescreened" offer of credit to you, however, the credit bureau is prohibited from including that inquiry in a future credit report about the consumer. Inquiries that can appear in a credit report are referred to in the industry as "hard" inquiries and inquiries that do not appear in a credit report – such as those resulting from prescreening – are referred to as "soft" inquiries.

HARD INQUIRIES

Hard inquiries (also known as "hard pulls") generally occur when a financial institution checks a consumer's credit when making a lending decision. They commonly take place when applying for a loan (including mortgage loans) or a credit card, and consumers must authorize them.

According to credit scoring bureaus, the leading developer of credit scores, people who apply for or open multiple credit accounts in a short period of time are riskier than people who have not applied for or opened credit accounts recently. More specifically, FICO has found that people who are actively seeking credit and applying for or opening multiple new accounts are less creditworthy and statistically much more likely to default on their credit obligations or declare bankruptcy.

In some cases, a series of similar hard pulls over a short period of time are aggregated by bureaus into a single inquiry. For example, if someone is looking to buy a car and they talk to three banks and a credit union and a dealer in one week, and all five pull reports to determine creditworthiness, bureaus will aggregate it as one inquiry—not five.

As a result, multiple hard inquiries can have a negative effect on a consumer's credit score. For most consumers, however, this effect is minimal – credit bureaus estimate that one additional hard credit inquiry will take less than five points off the score of most consumers. (credit scores range from 300-850, and in most instances a small difference of five points should not affect the price or availability of credit.) Moreover, where shopping for credit – e.g., looking for a mortgage and obtaining quotes from multiple lenders – the credit bureau will ignore inquiries made within the prior 30 days, and will consider inquiries made within 14 days of one another as a single inquiry. As a result, consumers who are shopping for mortgages, auto loans, or other types of credit are not penalized by multiple inquiries.

SOFT INQUIRIES

Soft inquiries (also known as “soft pulls”) typically occur when a financial institution makes a credit inquiry to determine whether to make a pre-approved offer of credit, or a pre-screened invitation to apply—typically when a consumer is NOT actively seeking credit. This also may occur when a creditor determines whether to increase an existing customer's credit line, checks to see if an existing customer qualifies for certain special offers. Employers running a credit check before making a hire, and monitoring activities by consumers are also counted as soft credit pulls.

Soft inquiries do not affect credit scores and may or may not be recorded in a credit report, depending on the credit bureau.