

Brenda Schmitt, ISU Extension  
Family Resource Management Field Specialist  
[Schmitt@iastate.edu](mailto:Schmitt@iastate.edu)  
641.423.0844  
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## **Managing Tough Times – Re-examining Lending Standards and Practices**

Within the current economy, credit is seen as a key culprit, and many lenders are re-examining lending standards and practices. With that in mind, it is especially important for consumers to pay attention to changes in their accounts.

Some consumers will find that their lenders have arbitrarily reduced the credit limits on their credit card accounts or their lines of credit. That's not surprising, since many lenders are seeking to reduce their exposure to risk. You might not worry much about reduced credit limits, unless the new lower limits cause you to be at risk of going over your limit, which can lead to stiff fees and/or penalty interest rates.

Reduced credit limits can affect your credit score, even if it does not directly affect your day-to-day finances. 30% of your credit score is based on the amount of debt you owe, and that factor goes beyond the actual dollar amount owed, and also includes an examination of the percentage of available credit that is in use.

For example, suppose you have \$20,000 of available credit (perhaps 4 credit cards, each with a \$5,000 limit); if you owe \$8,000 on those cards, then you are using 40% of your available credit (\$8,000 divided by \$20,000). What happens if the credit limits on those cards are substantially reduced? If you now have only \$12,000 of available credit, then you are using 67% of available credit. Any ratio above 50% will have a significant negative effect on a credit score. As you can see by this example, even when an individual makes no change at all, his/her credit score can go down.

Even the initial 40% ratio in this example is higher than what is recommended.

According to FICO, half of Americans have credit utilization ratios below 30% when it is recommended that people seek to be below 20% as a general rule. If you find yourself with a high credit utilization ratio, consider paying down your debt as quickly as possible - to improve your general financial security as well as your credit score.

Another action that has been taken by some lenders is to completely close certain consumer accounts. That can affect your credit score in that the percentage of available credit which you are using will be higher and it may reduce the length of your credit history.

Length of credit history is 15% of your score. Suppose you have 5 credit accounts (loans, credit cards, etc), and three of them are under two years old, one is 4 years old and the other is 10 years old. Closing the 10-year-old account would cause your credit score to drop noticeably. Even if there is nothing you can do to keep the account open,

it helps for you to be aware that this new negative factor is affecting your score. You may be able to compensate for it by reducing your amounts owed or improving your bill-paying record.

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