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Bill calls for cutting a break on credit score along with loan modification

U.S. Rep Jackie Speier, D-San Francisco, wants to protect homeowners going through home loan modifications from taking a hit to their FICO scores

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If you are lucky enough to get your lender to modify your mortgage, you shouldn't end up dogged by a miserable credit score.

That's the essence of a bill introduced in Congress last week by U.S. Rep. Jackie Speier, D-San Francisco. It would insulate people from taking a credit score hit going through loan modifications.

Speier is trying to give people a fresh start as they get either a permanent modification that makes monthly payments more affordable, or a temporary modification, which lenders sometimes use before considering permanent relief.

"I am seeing people with sterling credit have their scores dinged as much as 100 points," Speier said.

A 100 point drop is substantial. It can prevent people from getting loans on cars or homes, life insurance or even a job. For a small business, a credit score hit can be a death knell as lenders refuse a line of credit essential for operations.

"This is a doomed spiral," Speier noted.

According to the U.S. Department of Housing and Urban Development the No. 1 reason people are missing home payments is because they have lost a job or had to take a lesser paying job. About 16 percent of Americans are unemployed or underemployed and there are five applicants for every job available.

So if a lower credit score keeps people from getting a new job, that's counterproductive for the person and the economy, said Speier. She added that modifications benefit neighbors and communities because property values remain intact as people stay in homes, make payments and mow lawns.

But people who have paid their bills and sought no special help are not likely to see why some people should get special treatment.

Mark Calabria, director of financial regulation studies at the Cato Institute, says the recession shouldn't excuse accountability. "Most people who are late on their bills feel like they had a good reason," he said.

Mortgage modifications take different forms as lenders make monthly payments more affordable for homeowners. Some change interest charged on the loan. A few reduce the principal amount of the loan to reflect the downturn that's occurred in values, although that's rare. Regardless of the form of the modification, credit scores are lowered as the person's credit history reflects no longer paying according to the original terms.

The American Bankers Association says it is necessary for lenders to see when such changes have taken place.

"To deny information on modifications being used in credit scores only harms the ability of lenders to evaluate the creditworthiness of borrowers in the future, making it harder to determine a borrower's ability to repay any future loan," said Joseph Pigg, vice president and senior counsel of the association.

Calabria says if lenders are denied the ability to examine homeowners' payment history, banks might have to raise loan interest rates on a variety of clients to cover the potential risk of defaults. "What should banks use to predict the risk of a default?" Calabria said.

But Chi Chi Wu, an attorney with the National Consumer Law Center, says that joblessness and a 30 percent crash in the housing market the last few years are unique. "If you can't pay your bills because you've lost a job or because the bad actors of the financial system took advantage of you, does the score predict anything?" she said.

Lenders, she said, have become too reliant on the score rather than evaluating personal circumstances.

According to research released this month by Fair Isaac Corp., which produces FICO credit scores, about 25.5 percent of Americans have credit scores below 599 — a poor score that often interferes with their ability to get a car loan or even other credit cards. That's far below the long-term average of 15 percent. The best FICO scores range from 700 to 850.

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