**Credit Scoring Models**

* **A credit scoring model refers to a mathematical framework designed to gauge the creditworthiness of a borrower by determining the chances of default. Such a model provides a customized credit score for every individual or firm based on factors like borrowing history, financial position, and customer characteristics.**
* **The various factors contributing to credit risk estimation for a customer include their characteristics, credit history, previous defaults, credit utilization, etc.**
* [**Lenders**](https://www.wallstreetmojo.com/lender/)**design these frameworks using various techniques. Such as algorithms, including machine learning, logistic regression, binning algorithms, linear regression,**[**predictive analytics**](https://www.wallstreetmojo.com/predictive-analytics/)**, and cumulative accuracy profiles.**
* **However, the biggest challenge arises with the quality of data that serves as an input for processing credit information through these models.**
* [**Credit rating agencies**](https://www.wallstreetmojo.com/credit-rating-agencies/)**and credit bureaus often gather individual credit information. And process it through these models. They then sell this information to the lenders or**[**creditors**](https://www.wallstreetmojo.com/creditor/)**by charging a certain fee from them. Therefore, a high**[**credit score**](https://www.wallstreetmojo.com/credit-score/)**generally refers to higher chances of getting any financial product and lower chances of default.**
* **Credit Utilization Ratio (CUR): It is a measure of the proportion of credit used by the borrower against their stated limits. High CUR signals high credit usage and repayment burden, negatively affecting credit scores. Individuals and businesses with a 30-40% CUR tend to have better credit scores.**
* **modern credit scoring started in the 1950's with the judgmental approach commonly known as the 5C's approach (Character, Capital, Collateral, Capacity, and Condition).**
* **Because of the economic effects of the COVID-19 pandemic,**[**21% of Americans were denied credit**](https://www.bankrate.com/finance/credit-cards/credit-denial-survey/)**due to their low credit scores. Millennials were the hardest hit by the credit climate during the pandemic, with 32% of them having their credit applications denied. Meanwhile, only 22% of Gen Xs and 11% of Baby Boomers experienced rejection.**
* **There are various kinds of frameworks available for analysing the customer’s creditworthiness:**

1. **FICO Score: A FICO score is a model developed by the Fair Isaac Corporation. It provides a credit score on a scale from 300 to 850 for every individual or firm. The higher the score (more than 700), the lower the**[**probability of default**](https://www.wallstreetmojo.com/probability-of-default/)**. It has different versions, like**[**FICO Score**](https://www.wallstreetmojo.com/fico-score/)**2, 4, 5, 8, 9, 10 and 10T.**

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| **Range** | **Score Range** | **Percentage** |
| **Poor** | **300-579** | **16%** |
| **Fair** | **580-669** | **17%** |
| **Good** | **670-739** | **21%** |
| **Very Good** | **740-799** | **25%** |
| **Exceptional** | **800-850** | **21%** |

1. **Vantage Score: The second most popular credit scoring model is VantageScore, which was developed by Experian, Equifax, and TransUnion in 2006. It takes into account various factors such as credit history, duration, and credit utilization to draw a credit score from 300 to 850. It has multiple versions, while VantageScore 3.0 is the best one.**

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| **Range** | **Score Range** | **Percentage** |
| **Very Poor** | **300-499** | **5%** |
| **Poor** | **500-600** | **21%** |
| **Fair** | **601-660** | **13%** |
| **Good** | **661-780** | **38%** |
| **Excellent** | **781-850** | **23%** |