Your Credit Score (Handout)

Your credit score can have a major impact on your life. Not only do creditors typically check your score when deciding whether or not to approve your application and what interest rate to charge you if you are approved, but landlords, insurance companies, and even employers often check it as well. Having a good score can help you achieve your goals quickly and at the lowest possible cost.

What is a Credit Score?

A credit score is a numerical measure of your credit worthiness – the likelihood you will repay what you borrow. There are several types of scores available that are calculated using a variety of factors and weights, but they focus on the information in your credit report and not on personal factors such as race, gender, and income.

As the name implies, your credit report is a report of your credit activity. Credit includes things like credit cards, store cards, personal loans, car loans, mortgages, student loans, and lines of credit. For each account you have, your report shows who it is with, your payment history, the initial amount borrowed (for loans) or credit limit (for revolving credit, like credit cards), the current amount owed, and when it was opened/taken out. Your report also shows if you have experienced any credit-related legal actions, such as a judgment, foreclosure, bankruptcy, or repossession, and who has viewed your report (called an inquiry). There are three major credit bureaus that compile and maintain credit reports: Equifax, Experian, and TransUnion. Theoretically, all three of your reports should be the same, but it is not uncommon for one bureau to collect information that another one does not.

Today, instead of reviewing and evaluating the report itself, many creditors simply pull your credit score. Not only does it save time, but credit scores provide an objective, consistent way of analyzing applications.

FICO Scores

The most commonly used scoring model was developed by a company called Fair, Isaac and Company. Called a FICO score, it ranges from 300 to 850, with a higher score being indicative of less risk. Generally, those with a higher score are more easily granted credit and get a better interest rate. While there is no standard for what constitutes a "good" credit score, one benchmark to keep in mind is that many mortgage lenders require a score of at least 620 for approval and 740 for the best interest rate.

The following are the factors that are used to calculate your FICO score:

- **Payment history (35%):** Making your payments on time boosts your score. Conversely, if you make a late payment, your score will take a hit. The more recent, frequent, and severe the lateness, the lower your score. Collection accounts and legal actions, such as a bankruptcy, foreclosure, or judgment, have a serious negative impact. Some medical collections, however, are treated differently than other types of derogatory debt. In some credit scoring models unpaid medical collections may have less of a negative impact than other types of consumer debts.

- **Amounts owed (30%):** Carrying balances on revolving debts – like credit cards or lines of credit – that are more than 30% of the limit on the account will bring down your FICO score.

- **Length of credit history (15%):** The longer you have had your accounts, the better.

- **New credit (10%):** This factor looks at the number and proportion of recently opened accounts and the number of inquiries. While many inquiries on your report will lower your score, all mortgage or auto loan inquiries that occur within a 14 to 45-day period are considered just one inquiry for scoring purposes in the latest version of the FICO scoring model. Accessing your own report is not damaging to your score nor are inquiries for pre-approval offers. However, having too many new accounts can bring down your score. For this reason, you should only open accounts you are sure you need.

- **Types of credit used (10%):** Having a variety of accounts – both revolving and installment – boosts your score because it demonstrates that you are capable of handling the responsibilities that come with each debt type. Examples of revolving accounts include credit cards and lines of credit, while personal loans, car loans, student loans and a mortgage are types of installment accounts.

Since your Equifax, Experian, and TransUnion credit reports do not necessarily contain the same information, your FICO score from each bureau may be different. When you apply for credit, the creditor may only check one of your scores or check all three and average them or take the lowest or middle score.

Having a Low Score Can Cost You

Not only does your score play a major role in whether you are approved for credit, but it typically also influences the interest rate you are charged if you are approved. Your interest rate is not important for credit cards that you pay off in full each month, but for loans, having a higher interest rate can cost you a lot of money, as the chart below shows. A person with a score of 620 will pay over $150 more per month than a person with a score of 740. That adds up to an additional $54,609 over the life of the loan in this example.

How to Improve Your FICO Score

Following these habits can boost your score:

- **Always pay on time:** Your payment history makes up the largest chunk of your credit score, so making your payments on time is extremely important.
- **Pay down existing debt:** Even if you have never missed a payment, a large debt load will lower your score. Explore ways you can lower your interest rates and free up cash to make more than the minimum payments.
- **Avoid taking on additional debt:** Besides paying down existing debt, make an effort to not take on more debt in the future. For revolving credit, ideally you should not charge more than you can pay off in full the next month, but at the very least, try to keep the balance well under half of the credit limit.
- **Check your report for errors:** Many reports contain score-lowering errors. Check your credit report from the three bureaus at least annually, and file a dispute at the web site of the bureau reporting the mistaken information if you notice any errors. You can get a free copy of your report once a year from the Annual Credit Report Request Service (see page X).
- **Keep your old accounts:** A long credit history with the same accounts indicates stability.
- **Limit balance transfers:** While transferring balances to “teaser rate” cards can be a way to efficiently get out of debt, it can also have a detrimental effect on your credit score. The accounts will be new and likely have balances close to the limit to maximize the advantage of the low rate – two factors that lower your score.

$200,000 / 30-Year Mortgage				
FICO Score	Interest Rate*	Monthly Payment	Total Paid Over Life of Loan	Interest Paid Over Life of Loan
740-850	3.75%	$879.92	$316,770.87	$126,770.87
700-739	3.90%	$896.17	$322,620.78	$132,620.78
680-699	4.10%	$918.08	$330,506.58	$140,506.58
660-679	4.40%	$951.45	$342,518.87	$152,518.87
640-659	4.70%	$985.41	$354,749.14	$164,749.14
620-639	5.10%	$1,031.60	$371,380.03	$181,380.03
300-619	Denied			

* These interest rates are intended as an example only – check with your lender for the actual rates. This example assumes a down payment of 5%.

- **Avoid excess credit applications:** Frequently applying for new credit can bring down your score. If you do it frequently, a creditor may see it as a sign that you need to rely on credit to pay your bills.
- **Be patient:** It may feel like credit mistakes can haunt you forever, but your payment history from the past two years is more important that what happened before that, and most negative information is removed from your report after seven years.

Beware of Credit Repair

Some companies claim to "repair" your credit score and report, often for a very high fee. At best, the company is charging you for something you can do yourself for free: writing a letter to the creditor bureaus disputing inaccurate information. At worst, the company is engaging in dishonest and/or illegal tactics.

Credit repair companies frequently operate by flooding the credit bureaus with letters that dispute negative, but accurate, information. If the credit bureaus are unable to investigate the claims within 30 days, the information is removed. The company then shows you a cleaned-up report. This rarely works, though. Even if the credit bureaus are backlogged with disputes, they will eventually get to your claims and just reinsert the negative information when they verify that it is accurate.

Another common tactic credit repair agencies use is to issue consumers a new identity, complete with a stolen Social Security number or tax identification number to use in place of a Social Security number. This is an illegal practice for which the consumer often ends up paying the price. Remember, there is no legal way to remove accurate and timely information from your credit report.

Rapid Rescoring

Rapid rescoring is a fee-based service that is offered by some mortgage lenders and brokers to help accelerate the credit report dispute process. Instead of having to wait for weeks, corrections may be made within several days or less. Items that can generally be corrected or removed using rapid rescoring include erroneous late payments, accounts that should have aged off your report, accounts that are not yours, and incorrect balances. Rapid rescoring may also help you update your credit report quickly if you just paid off a debt.

Beware of rapid rescoring companies that market directly to consumers. Rapid rescoring is only offered through lenders, so any offers to consumers directly may likely be a scam.

VantageScore

The VantageScore was created by Equifax, Experian, and TransUnion as an alternative to the FICO score. Your VantageScore consists of both a numerical score and letter grade. (Like with your FICO score, you have a VantageScore from each bureau.) Scores range from 300-850 in the newer scoring model, 501-990 in older versions (the higher the better).

While your FICO score and VantageScore both only consider the information in your credit report, the categories and weights for each are somewhat different. The factors that are used to calculate your VantageScore are ranged from most influential to least influential:

- **Payment history:** Repayment behavior (satisfactory, delinquency, derogatory) – Extremely Influential
- **Age and type of credit:** Length of credit history and type of credit– Highly Influential
- **Percent of Credit Limit Used:** The proportion of credit amount used/owed on accounts – Highly Influential
- **Total balances/debt:** The total amount of recently reported balances (current and delinquent)) - Moderately Influential
- **Recent credit behavior:** The number of recently opened credit accounts and credit inquires – Less Influential
- **Available credit:** The amount of credit available – Least Influential

The same practices that can help you to have a good FICO score can also boost your VantageScore.

Bankruptcy Risk Scores

Bankruptcy risk scores have been developed by several companies. Instead of evaluating your general credit worthiness, your bankruptcy risk score is designed to predict the risk that you will file for bankruptcy. The specific calculation method is not public information, but it is hypothesized that the main factors considered are the same ones that your FICO score is based on, plus your spending habits.

Internal Scores

In lieu of or in addition to FICO score, many creditors use their own scoring model. They may look at factors that the FICO score does not consider, but generally, if you make your payments on time, keep your balances low, and practice other habits that are necessary to have a good FICO score, you will have a good score under other models too.

Non-Traditional Credit Scores

Since credit scores come directly from credit report data, what happens if you have never had any credit? You won't have a credit score in most models. If you want to get a mortgage or car loan in the future, not having a credit score can be a serious impediment. However, there are some lenders that will accept a "non-traditional credit score."

Several companies have developed non-traditional scoring models, and the trend in the industry seems to be toward casting a wider net for data on which to generate scores. Non-traditional scoring models take payment data from non-credit sources, which can include:

- **Landlords**
- **Utility companies**
- **Banks/credit unions**
- **Payday loan companies**
- **Rent-to-own businesses**

To have a good non-traditional score, it is extremely important that you pay your bills on time.

Lenders typically will only consider your non-traditional credit score if you do not have a traditional credit score. Even then, there are some lenders that will not use it. If you do not currently have a credit score and would like to get a mortgage or car loan in the future, you may want to obtain a credit card or store card now and start building a traditional credit history. If you are unable to get approved for a regular card, you may want to get a co-signer or apply for a secured credit card. A secured credit card requires you to make a deposit, which the creditor will draw from if you do not make your payments. Secured credit cards may charge an annual fee, but they generally provide you with the option of converting your account to a "regular" credit card after a pre-agreed number of consecutive on-time payments are made.

Obtaining Your Credit Score

If you are denied credit or insurance or receive less favorable terms due to your credit score, the creditor or insurer is required to provide you with the score they used at no cost. Otherwise, if you want to see your score, you have to pay for it. You can purchase your Equifax, Experian and TransUnion FICO score from FICO. (See contact information on this page.) Visit the web sites of the credit bureaus listed on this page for information about purchasing credit scores developed by the bureau.

Keep in mind that there are a variety of services that sell credit scores. When you purchase your credit score, it is extremely important to pay attention to what score you are purchasing. Some scores that are made available to consumers to purchase are not actually used by lenders. Since it is the mostly widely used, it generally makes the most sense to purchase your FICO score. However, even then, keep in mind that you may not be seeing the exact same score a lender will see.

Checking your credit score can be helpful if you are planning to get a mortgage or car loan soon and want to have an idea if you will get approved or qualify for the best interest rate. The best way to make sure you are looking at a similar score to the lender is to simply ask them what score they use.

When to Ignore Your Score

While most people should take an active role in creating and maintaining a good credit score, not everyone needs to maintain a constant focus on it. You may not need to concentrate on your score if:

- **Your score is already excellent –** The only advantage to having an 830 FICO score instead of an 810 is bragging rights. Both scores likely qualify for the exact same interest rate.

- **You will not be using it –** If you already have everything you need – a home, a car, credit cards – and won't be looking for a job or insurance products in the future, a credit score has little meaning. You don't want to start paying your bills late or taking on an excessive amount of debt, but there is no need to stay up at night worrying about your credit.
- **You have more important financial issues to deal with –** If you are saddled with overwhelming debt, don't have money for essential expenses, have legal issues to contend with, etc., your credit score rates a distant second to focusing on your more pressing problems. Remember, you can always improve your score through responsible credit use in the future.

Contact Information

- **Equifax**
  www.equifax.com • 800.685.1111
- **Experian**
  www.experian.com • 888.397.3742
- **TransUnion**
  www.transunion.com • 800.888.4213
- **FICO**
  www.myfico.com • 800.319.4433
- **VantageScore**
  www.vantagescore.com
- **Annual Credit Report Request Service**
  www.annualcreditreport.com • 877.322.8228

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What's Your Credit Score "Score"? Quiz

Answer **True or False** to the following statements.

1. Checking my own credit report hurts my score.	☐ True ☐ False
2. My scores from all three bureaus must always be the same.	☐ True ☐ False
3. Payment history is the largest factor used to calculate my score.	☐ True ☐ False
4. For scoring purposes, information on my credit report that is five years old matters as much as information that is a year old.	☐ True ☐ False
5. My income is factored into my score.	☐ True ☐ False
6. I can get a lower interest rate with a score of 850 than a score of 810.	☐ True ☐ False
7. All applications for mortgage or auto loans within a 30 to 45-day period are considered as just one inquiry for scoring purposes.	☐ True ☐ False
8. Carrying a balance close to the credit limit will harm my score.	☐ True ☐ False
9. If I have never had any credit, I do not have a traditional credit score.	☐ True ☐ False
10. If I need to clear up errors on my credit report, using a credit repair company is the best method to do so.	☐ True ☐ False

Scoring Key:

More than 8 correct – You understand the credit scoring process; now do what it takes to create and maintain good scores.

5-7 correct – You are clear on some important aspects of credit scoring, but learn more to make sure you know what it takes to create a great score.

Less than 4 correct – Now that you know what you don't know, learn the facts about credit scoring – misinformation can hurt you.

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