



GET SMART ABOUT CREDIT



What Does Your Credit Score Say About You?

In our grandparents' era, Americans who wanted to borrow money paid a visit to a lender who already knew much about the family's financial history and money-management practices—what they owned, what they owed, and whether they paid their bills on time. From that knowledge, the lender would decide either to make or deny the loan. Today, most lenders don't know their customers personally. Instead, they use a credit score determined by a mathematical formula to decide who is a good credit risk and who is not. Each score is based on the information in your credit report.

Your credit score is a figure—usually between 300 and 850—that reflects your credit history. Lenders use your score to determine whether you're a good candidate for a loan. Lenders also use the score to decide the interest rate and terms.

Most people score in the 600s and 700s. If your score in the 400s and 500s, you'll likely be charged a higher interest rate and will need a larger down payment than someone with a higher credit score. If you're planning to make a large purchase on credit, check your credit score 6 to 12 months in advance so you can take steps to raise your score.

The FICO Score

Several different companies calculate credit scores and supply them to creditors. The Fair Isaac Corporation developed the commonly used FICO score. A FICO Score covers many kinds of accounts, installment loans, finance company accounts, and mortgage loans.

Lenders buy your FICO score from three national credit reporting agencies: Equifax, Experian, and TransUnion.

Consumers have been allowed to view their own scores since 2001. However, you won't have a FICO score unless one or more of your accounts is at least six months old and includes updated information from a lender.

How scoring works

To determine your score, the FICO system uses your credit history in five major areas:

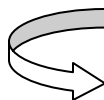
1. Payment history
2. Amount owed
3. Length of credit history
4. New credit
5. Types of credit in use

Payment history. Your payment history has the largest impact on your FICO score: 35 percent is determined by your credit account payments. If you pay your bills on time and don't miss payments, your score will be higher. Recent payment activity counts more than payment history of years ago. A 90-day late payment that you made in the last 30 days affects your score more than a 120 day late payment you made five years ago. The score reflects how late the payment was, how recently it occurred, how much you owed, and how many payments were late.

If you resume on-time payments after a string of late payments, your score will increase. Reports of bankruptcies, foreclosures, lawsuits, wage garnishments, liens, and judgments will lower your credit score. Bankruptcies will stay on your credit report for 10 years.

Amount owed. The amount you owe determines 30 percent of your credit score. Even if you pay off your credit card bills every month, the balance of your last statement may be included in your credit report, which influences your credit score. Your score is reduced if you "max out" or carry large unpaid balances on several credit cards because you "appear" overextended. Carrying a small balance that you pay off shows that you manage your credit responsibly.

You can increase your score by getting credit only when you need it and by staying under your credit limits. It's better to pay off debt than to transfer balances from one credit card to another.



Length of credit history. The length of time you have built a credit history contributes 15 percent of your credit score. The longer you have used credit the higher your score. The score takes into account the age of the oldest account and an average age of all your accounts. If you have just opened several accounts, the average age will go down, which will lower your credit score.

New credit. Think again before you apply for that credit card giving you 10 percent of any purchases you make that day. Ten percent of your credit score is based on recent requests for credit. The number and type of accounts will influence your credit score, as will the date you opened them. If you suddenly apply for several credit cards, lenders may think you have overextended yourself and be reluctant to give you more credit.

Types of credit in use. The types of lenders you do business with determine the last 10 percent of your credit score. Your score will be higher if your borrowing is from a cross-section of reputable lenders. But don't open accounts that you don't need just to achieve variety.

Your score won't be affected if you ask for your own credit report. Nor will it be damaged if firms ask about you before offering credit you didn't apply for. But if you apply for several loans or credit cards at once, leading to numerous inquiries from lenders, your credit score will lower. An exception is shopping around for the best loan when you're buying a car or home. The inquiries these lenders make within a two-week period in these instances are counted as one.

As you can tell, your credit score uses a wide range of information about you. However, it doesn't include your race, color, religion, national origin, gender, marital status, age, salary, where you live, or current interest rates you're paying.

Not just one score

There are many types of credit scores. They are developed by independent companies, credit reporting agencies, and even some lenders. As a rule, the higher the score, the better.

Each credit reporting company calculates your score and each score may be different because the credit history each agency has about you may be different. Lenders may make a credit card or auto loan decision based on a

single agency's score, although others such as mortgage lenders often will look at all three scores.

Your credit score changes when your information changes at that credit reporting agency. This is good news! It means you can improve a poor score over time by improving how you handle credit.

Boosting your scores

Here are some general ways to improve your credit scores:

- **Pay your bills on time.** Delinquent payments and collections can really hurt your score.
- **Keep balances low on credit cards.** High debt levels can hurt your score.
- **Pay off debt rather than moving it between credit cards.** The most effective way to improve your score in this area is to pay down your revolving credit.
- **Apply for and open new credit accounts only when you need them.**
- **Check your credit report regularly for accuracy.** Contact the creditor and credit reporting agency to correct any errors.
- **If you have missed payments, get current and stay current.** The longer you pay your bills on time, the better your score.

Reference:

Your Credit Scores, CFA & Fair Isaac,
www.myfico.com

Adapted from:

What Does Your Credit Score Say About You?,
University of Idaho-Extension, Barbara D. Petty,
Bulletin 841 #5, September 2004.