

What Does Your Credit Score Say About You?

In our grandparents' era, Americans who wanted to borrow money paid a visit to their banker. Often, the banker 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 banker 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.

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

Most people score in the 600s and 700s. If you score in the 400s and 500s, you'll 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, including credit cards, retail accounts, installment loans, finance company accounts, and mortgage loans.

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 the scoring works

To determine your score, the FICO system uses your credit history in five major areas: payment history, amount owed, length of credit history, new credit, and 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 tick upward. Reports of bankruptcies, foreclosures, lawsuits, wage garnishments, liens, and judgments will hurt your credit score. Bankruptcies will even stay on your credit report for 7 to 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. That makes you look overextended. Carrying a small balance and paying it off shows that you can manage 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 card to another. Closing unused credit card accounts won't raise your credit score. Neither will opening several new accounts to try to increase your available credit.

- **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 your 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 off any purchases you make that day. Ten percent of your credit score is based on recent requests for credit. The number and type of new 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 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 you 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 can indeed suffer. 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 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.

You can receive your credit score by contacting any of the major credit reporting agencies:

Experian (formerly TRW): (888) 397-3742,
www.experian.com

Equifax: (800) 685-1111, www.equifax.com

TransUnion: (800) 888-4213, www.transunion.com

Further Readings

Understanding Your Credit Score. Fair Isaac Corporation.
<http://www.myfico.com>.

Credit Reports. J. McKenna and C. Makela. Colorado State University Cooperative Extension. <http://www.ext.colostate.edu/PUBS/CONSUMER/09141.html>.