Your Credit Score

Standard 7

The student will identify the procedures and analyze the responsibilities of borrowing money.

Lesson Objectives

- Describe the purpose of a credit report.
- Define the role of credit scores.
- Explain the importance of a good credit score.

Personal Financial Literacy Vocabulary

Credit bureau: An establishment that collects and distributes credit history information of individuals and businesses.

Credit history: A record of borrowing and .

Credit report: An official record of a borrower's credit history, including such information as the amount and type of credit used, outstanding balances, and any delinquencies, bankruptcies, or tax liens.

Credit score/rating: A measure of creditworthiness based on an analysis of the consumer's financial history, often computed as a numerical score, using the FICO or other scoring systems to analyze the consumer's credit.

FICO: The most commonly used credit score. The name comes from the Fair Isaac Corporation, which developed the scoring model.

Introduction

Julie did not understand why her loan application for a new car was denied. She had several friends with new car loans and several credit cards, and they all laughed about missing payments once in a while. She had decided it was no big deal to miss a few herself, even though she hated paying those late fees. After all, her parents had good credit so she figured she could always borrow from them if she needed money. And her friends all had new cars; why not her too?

Susan knew she had missed a couple of car payments when she lost her job. She was glad to finally start working again, even though it would be a few weeks before she got a paycheck. She decided not to tell anyone she was behind on her bills and just do her best to get caught up. She even thought about getting a credit card to help get her by. When she went online to check her credit score, she was shocked. It had been close to 700, but was now only 450. Now she was not sure about applying for a credit card.

What advice would you give Julie and Susan? Will they be able to get their applications approved?

Lesson

When you apply for a loan or credit card, most lenders know everything about you or your creditworthiness. It is their responsibility to get as much information as possible to make a good decision because they want to be sure you are willing and able to make the payments. While you want or need the money, they are concerned about your ability to pay it back. The information you provide on a loan or credit card application is just the beginning. Generally, when you sign that application, you are giving them permission to check other sources of information about you and your money habits.

One of the most reliable sources of information about your creditworthiness is your credit history, which includes every application you made for a loan, a credit card, or an apartment lease within the last two years, along with the amount of credit you currently have, your required monthly payments, and other similar types of information. Specialized businesses called credit bureaus compile all of this information into a file called a credit report. Your credit report can be requested by anyone with a specific need to know if you have given them permission to review it.

Lenders in the United States rely on three main credit bureaus: Equifax, Experian, and TransUnion. Different lenders and creditors subscribe to one of more the credit bureaus, so your credit history at each one may be a little different. Most credit files contain the following information:

- Your identifying information, which includes your name, Social Security number, date of birth, and your past or current employers.
- Your credit accounts, such as bank accounts, savings accounts, car loans, credit card accounts, the date you opened each account, the credit limit on each account, the loan amount, the balance due, the minimal payments, and your payment history (late payments, on-time payments, etc.).
- Credit inquiries, which show the number of times you have applied for credit, where you applied, whether or not you were turned down, and other similar information for the past two years.
- Public records and collection information, including judgments, tax liens, bankruptcies, outside collection agency actions, etc.

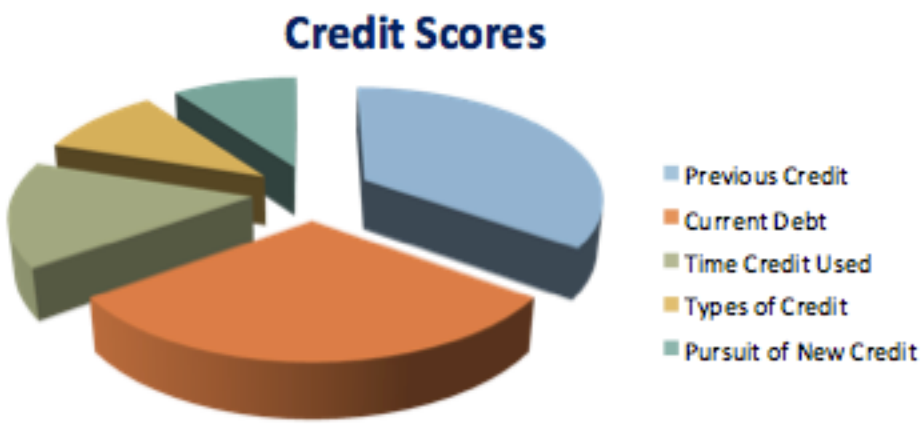
The information in your file is used to generate a credit score, often called a FICO score because many scores are now based on a formula developed by the Fair Isaac Corporation. Because the information reported by each credit bureau may vary, you will have a credit score from each of the three credit bureaus and it may vary somewhat. FICO scores are simply a way of standardizing your credit scores, making them easier for potential lenders or creditors to understand. These scores are important because they become the basis for decisions about approving your application.

FICO scores, however, are only one tool that lenders use. They may also consider your income, how long you have worked at your job, how often you have moved, the type of credit you are requesting, and other characteristics that give them a more complete picture of your ability to repay the loan.

Calculating FICO Scores

When calculating your FICO score, the most important factor is your ability to pay your bills, or how you have managed credit in the past. Second is how much debt you have currently. Following is a percentage breakdown of the credit scores and a pie chart that shows those percentages:

Your credit history	35%
Your current level of debt	30%
How long you have used credit	15%
The types of credit you use	10%
Your pursuit of new credit	10%



Information NOT Included In Your FICO Score

- *Your race, color, religion, national origin, sex, and marital status.*
- *Your age.*
- *Your employer, job title, salary, or other employment history.*
- *Your address.*
- *Any interest rates you pay on other loans or credit cards.*
- *Items such as child support or rental obligations.*
- *Certain requests for your credit information, such as inquiries from potential employers or promotional offers such as preapproved credit card letters.*
- *Any information not found in your credit report.*
- *Any history of credit counseling.*

What Difference Does it Make?

Credit scores are frequently used for more than just credit. Most housing or apartment leasing agencies will check your credit report before renting you a place to live. Your insurance company will check your score as part of the process for determining your insurance premiums. Many potential employers will check your credit score before offering you a job. Why? Because your ability to manage your money says something about you. A higher credit score shows you pay your bills on time, you are a responsible individual, and you show maturity when making important decisions.

Lower credit scores indicate you are a high risk choice as a potential borrower, renter, or employee. High scores tend to result in more job opportunities, lower interest rates, and lower insurance premiums, while lower scores reduce potential job opportunities, raise your interest rates, limit your credit opportunities, raise your insurance premiums, and increase your utility deposits.

REMINDER

When preparing your budget, be sure to include deposits to your savings account as a FIXED expense. The best budgets always start with paying yourself first!

FICO scores range from a high of 850 to a low of 300. The following table shows the difference in each range of credit scores:

Range	Potential for making late payments	General comments about the range
800 plus	1 in 100	Exceptional score that is well above the average; easy approval with preferred interest rates or premiums
740 to 799	2 in 100	Very good score that is above the average; may still qualify for preferred interest rates or premiums
670 to 739	8 in 100	Good score that is average; generally considered to be acceptable for most lenders with no preferred rates or premiums
580 to 699	27 in 100	Fair score that is below average; may be difficult qualifying for a loan; may also have an increase in interest rates or insurance premiums
579 and lower	61 in 100	Poor score that is significantly below average; may result from bankruptcy or other negative credit actions; very difficult to qualify for loans; often requires higher deposits for utilities, credit, or other applications

Additionally, the following table gives an indication of the impact that FICO scores can have on the amount of interest you would pay in each range, which also impacts your monthly payment. As you can see, good credit can make a difference in your overall financial well-being. Even though this table stops in the low 600s, it does not mean that people with lower scores cannot qualify for loans; it does, however, suggest they will have a much more difficult time getting credit and will pay even higher interest rates and monthly payments. They may also fail to qualify for many employment opportunities, especially jobs that require them to handle money as part of their job responsibilities.

Your FICO® Score	Your interest rate	Your monthly payment
760 - 850	5.66%	$867
700 - 759	5.89%	$888
680 - 699	6.06%	$905
660 - 679	6.28%	$926
640-659	6.71%	$969
620 - 639	7.25%	$1024

Negative or Inaccurate Information

Negative information, such as late payments and loan defaults, stay in your credit files for seven years. Other information, such as bankruptcy, remains in your files even longer. Bankruptcy remains for a maximum of ten years; information about lawsuits or unpaid judgments remains seven years or until the statute of limitations expires, whichever is longer.

If the information in your credit file is accurate, there is little you can do about it. However, if you believe the information is incomplete or inaccurate, you have a right to file a dispute with the credit bureau. Disputes can be filed online, by phone, or by certified letter.

Both the credit bureau and the company providing the information are required by law to investigate any disputed information. If the information is inaccurate, they are also required to correct it. Even though the dispute may not be resolved to your satisfaction, you can send the credit bureau a statement explaining your side of the story and ask them to provide a copy of your statement to anyone requesting information about you. However, you may have to pay a fee for this service.

Before applying for a loan, it is highly recommended that you check your credit report. Getting a copy of your credit report gives you the opportunity to review what is reported and to check it for errors. You are allowed to receive one free copy of your credit report from each credit bureau annually. You can also receive a free copy of your credit report any time you are denied credit, insurance, or a job based on your credit history.

Unfortunately, companies who promise to remove negative information from your credit files to give you a higher score or a new credit identity are scams. The only way to improve your credit score making your payments on time for a period of at least six month. Once you have re-established a pattern of regular, on time payments, your score will start to gradually increase. Do not waste your money or risk becoming the victim of identity theft by giving your personal information to any one or any group that promises to repair your credit.

Conclusion

Your credit report is one of the most important sources of information that others use to make decisions about your creditworthiness. Protecting your credit history is a key factor in building a successful financial future. While mistakes may happen, getting back on track as soon as possible will save you money and help you advance in your career because others will be using it to determine whether or not you qualify for a loan, a job, an insurance policy, or even a place to live. The best way to maintain a positive credit history is to control your level of debt and pay your bills on time.

FINAL NOTE: Julie and Susan definitely need some help. Late payments have a big impact on their credit scores, making it more difficult for Julie to get a car loan and Susan to get a credit card. While they may still be able to get credit, they will undoubtedly be paying higher interest rates. Both would be better off applying for more credit once they can better manage the payments they have.

Name:________________________________Class Period: ________________________________

Your Credit Score Review 7.3

Answer the following questions and give the completed lesson to your teacher to review.

1. Explain the role of a credit bureau.

2. What is a FICO score?

3. Why do lenders use a person's credit report and FICO score?

4. Why do people with high FICO scores usually pay lower interest rates than people with low FICO scores?

5. What should you do if you find inaccurate information in your credit report?

Name:______________________________Class Period: ______________________________

Making a Loan Activity 7.3

Each of the following individuals has applied for a $10,000 loan. Based only on the information given, would you loan the money to them? Explain why or why not.

Matt *Age 20*	Matt started working at a local auto parts store when he graduated from high school. He had a credit card, but lost it and never got another one. He rarely used it and has no other credit. He listed his favorite teacher and his boss as references for the loan. He has a checking account with a low balance, lives at home with his parents, and has no savings account. He makes a $200 monthly car payment. He wants to use the money to invest in a new business.	**Yes or No** **Explain:**
Merideth *Age 18*	Merideth lives at home but is planning to get married this summer. She wants to use the money to help pay for the wedding because her parents have limited income and little money to help her. She has a good job, has a good credit history, and has never been late with a payment. Her future husband is unemployed, and she helps pay his bills.	**Yes or No** **Explain:**
Al *Age 25*	Al dropped out of college to work because he got into debt with credit cards. He has been working to pay off the bills, and his credit score is improving as his debt drops. He has lived in an apartment with a friend for five years, has a $25,000 loan on his truck, and makes good money working in the oil fields. He recently opened a savings account and has a retirement fund with his employer. He wants to buy a motorcycle to reduce his gasoline payments.	**Yes or No** **Explain:**

Rhoda *Age 30*	Rhoda just recently bought a house and wants to borrow money to remodel it. She has a great job as an assistant to the president of a big company. She has one credit card, makes her payments on time, and has an excellent credit report. Her small house is close to work, so she can walk every day and she usually takes her lunch instead of eating out. She bought a new car five years ago, and it is now paid off.	**Yes or No** **Explain:**
Hong Age 25	Hong graduated from college with a degree in business. He now owns a restaurant, drives a Porsche, bought a new house, and has maxed out five credit cards to open his business and buy new clothes to look sharp. So far, he is managing to make all of his payments, except for his student loans. He wants to borrow the money to expand his restaurant business in hopes of generating more income.	**Yes or No** **Explain:**