

Credit: How Do You Score?

Sandy Preston, UNL Extension Educator, Dixon County
Mary Ann Holland, UNL Extension Educator, Cass County
Leanne Manning, UNL Extension Educator, Saline County
Kathy Prochaska-Cue, Extension Family Economist and Accredited Financial Counselor

This guide explains why credit file information and credit scores are important to consumers, how to correct inaccurate information and how to improve a credit score.

Why is the Information in Your Credit File Important?

We have all heard the terms “credit files” and “credit scores,” but what do they really mean? Bottom line, the information in your credit files is the basis for your credit score, and your credit score determines what interest rate you pay for credit.

Consumer Reporting Agencies (CRAs) gather information about you and sell it to creditors such as banks and credit unions, current and potential employers, insurers, and others with a legitimate right to know, such as landlords and utility companies. The most common type of CRA is the credit bureau. Three major national credit bureaus are Equifax, Experian and TransUnion.

You can check, at no cost to you, the information in each of the three credit reporting agencies once a year by logging on to “Annualcreditreport.com.” A copy of the information in your credit file is free. If you want your credit score, you will pay a small fee. Keep track of the information in a credit file by staggering the three credit file checks requesting one report every four months. If you have been turned down for credit, you can obtain a copy of your credit file at no cost.

Free credit file checks also may be offered if a credit account (usually a credit card number) has been mishandled by a creditor exposing a credit account to potential fraud. For example, one of the authors of this lesson now checks her credit files in all three reporting agencies monthly since she was informed that one of her credit

card account numbers may have been in a data file on a laptop computer stolen from a locked car.

What Information is in a Credit File?

Credit files include four categories of information: identifying information, credit use information, public record information and information about inquiries.

Identifying Information

The credit file includes information identifying you. This protects information by assuring that only people who have legitimate reasons may access a credit file. Identifying information includes name, present and past addresses, date of birth, phone number, and current and past employers. Maiden names or nicknames also may appear in a credit file. A credit file includes a Social Security number but that number should not be included in requested copies.

The information identifying the credit file is not used to calculate a credit score.

Credit Use Information

An important component of a credit file is the credit use history compiled by each of the three national credit reporting agencies. Where and how credit has been used both currently and in the past is included in this history. Besides listing all past and present credit accounts, information on each account tells when the account was opened, the current balance (how much is owed); how much credit is available to you (line of credit or credit limit), monthly payment amount, and the current status of the account (if any payments have been past due).



A historical timeline shows the record of payment on each account for at least two years. Credit information is collected from a variety of sources including financial institutions, mortgage and other lenders, retail store credit accounts, credit card accounts and collections accounts. Since creditors may not report to all three national CRAs, information in the three files may vary.

Information can remain in a credit file for seven and a half years from date of last activity on a credit account, except for bankruptcy. Bankruptcy remains in a credit file for 10 years. Unpaid tax liens are part of a credit file until they are paid. Once paid, tax liens are deleted from a credit file in seven years.

Repossessions and collections are accounts that are so delinquent that they have been turned over to a collection agency or the collection branch of a major creditor. Creditors also will report charge-offs for accounts that are in default of the original terms of the contract. Technically, a “charge-off” is a bookkeeping term used to indicate the date the creditor reports it as a loss on their business taxes; if it gets paid after that date, a “recovery” is reported in the business’s records. Some consumers mistakenly think they don’t need to pay charged-off debts. Charged-off debts can be subject to further collection action at a later date.

Late payments also are part of a credit file, and are recorded as 90-, 60- or 30-days late. The historical timeline also records exactly which month the account went into default.

Accounts in good standing may be reported using terms like “current,” “paying or paid as agreed” or “never late.” The timeline record shows “on time” payments.

Public Record Information

Public records include information such as bankruptcies, court and default judgements, liens, foreclosures and overdue child support payments. Dates of such legal action are noted in a credit file. If you know negative legal information is part of your credit file, be honest with a potential creditor when applying for future credit. Tell the creditor the reason for the negative information (illness, divorce or job loss).

If you are not granted credit the first time, wait a few months before applying for credit again. Waiting gives you time to establish a better credit record. When you do get credit, always pay all debts on time.

Inquiry Information

The final category of credit file information is entitled “credit inquiries.” Anyone who has accessed a credit file for the past two years is included. Some inquiries are for promotional purposes such as for pre-approved credit cards. Other inquiries represent an “account review” when creditors scan their customers to see if there has

been any deterioration of payment performance. These two types of inquiries will not affect your credit score.

What will affect a score is the number of inquiries for new credit. When you apply for a mortgage or car loan, you sign a form giving the creditor permission to obtain a copy of your credit file. The CRA notes each request for your credit file. If there are multiple requests for your credit file within a 45-day time period, your credit score will drop.

Disputing Information in Your Credit File

If you find incorrect information when you check your credit file, you have a right to dispute that information in a 100-word statement. Your statement must be included in all future requests for your credit file, and must be sent to anyone who has requested your information within the previous six months. Information can be disputed online, by phone or by mail. Some well-known problems associated with getting a credit file corrected are:

- Credit bureau refuses to delete inaccurate data because the credit grantor, through an automated system, “verified” it as accurate.
- Disputed information actually was deleted, but later was reinserted because the credit grantor re-reported it, and credit bureau “screens” failed to catch it.
- The computer program used by the credit bureaus causes misinformation to be incorrectly mixed into your credit report data because your name or Social Security number is similar to someone else.

What is a Credit Score?

In the past, a credit score was a FICO score developed by the Fair, Isaac and Company. A three-digit number, FICO scores ranged from 300-850. Scores 680 and above were considered “prime borrower” while scores between 560 and 679 were “sub-prime.” Scores below 560 were defined as “cautious.”

Recently, the three national CRAs introduced their own scoring system, VantageScores, which range from 501-990. VantageScores also are grouped into five categories: 901-990 equals “A;” 801-900 equals “B;” 701-800 equals “C;” 601-700 equals “D;” and 501-600 equals “F” credit. For both systems, the higher the credit score, the better. Use of this new system by all three CRAs will ensure that your credit score is the same at each credit bureau.

Both scoring systems are based on the same data and used by creditors to determine how creditworthy a potential borrower is. In other words, **how likely are you to repay a debt?** The score reflects the information in your

credit file including how much debt you have, how much unused credit capacity you have, how good you've been in the past at paying back credit obligations, and how many credit applications you have outstanding.

Lenders use the credit score to determine what rate of interest will be charged to a specific consumer. Insurers use credit scores to determine premiums. Landlords use credit scores to determine whether to rent to you or not. Utility companies use credit scores to determine whether to give you service and how much deposit is required to open a new account.

The same credit score is not interpreted in exactly the same way by each potential creditor. If you don't get the interest rate you want from one creditor, try another creditor who may determine that your credit score qualifies you for a lower interest rate at his or her business.

What Affects a Credit Score?

A number of factors affect a credit score including:

Any late payments? If so, how often?

How much is owed? On what types of accounts? A specific creditor may value one type of account more than another.

How many credit accounts do you have? Again, each creditor will decide how many is too many. Even if they have no balance, too many accounts are considered negative.

How many of your credit accounts are "maxed out?" If you have one maxed out credit card, for example, and two cards with low or no balance, consider transferring some of the debt from the maxed out one to the others to get rid of that negative information.

How long have you used credit? The longer, the better.

How long since you opened a new account? Opening several new accounts within a certain time period will lower your credit score.

How many recent inquiries? Too many inquiries are negative. Each creditor determines how many is too many within a specified amount of time. If you are shopping for financing for a home or a car, for example, several inquiries may show up in your credit file. If you then do take on the new loan, creditors will understand why you have those inquiries.

If you have a poor credit history, **how long have you been in good standing?** It is true that you can outlive negative credit information such as bankruptcy or foreclosure. It just takes time.

Do you use a mix of credit? Having only credit card debt or only installment loans will count against your credit score. Creditors want to see that you use a variety of types of credit.

To Improve a Credit Score

If you are turned down for credit, contact the creditor where you applied, asking for the reasons for denial. At your request, reasons must be given to you in writing. These reasons for denial will give you suggestions for improving your credit file.

Nine Tips for Improving a Credit Score

Have enough but not too much credit. Creditors need to know that you know how to handle credit obligations responsibly. But don't apply for new credit when you already have plenty available to you. For example, don't agree to open a new credit card just so you can get the discount many stores offer with your first purchase on their card.

Pay bills on time. If you have an emergency and can't pay credit bills on time one month, try to bring any past due accounts current as soon as possible.

Don't exceed the credit limit for credit cards and revolving credit. Credit cards charge an over-the-limit fee that may be reported in your credit file.

Don't ask a creditor to lower your credit limit. This reduces the gap between your available credit and balances on your accounts. The closer you are to using all of your available credit, the lower your credit score. Also, don't transfer balances from a high-limit credit card to one with a lower limit for the same reason.

Pay off debts especially revolving accounts such as credit cards. Aim to always have credit card balances at no more than 30 percent of the credit limit on each account. If you can't pay all your credit cards, start by paying extra to the accounts where you are closest to the credit limit. Once your credit card balances are below the 30 percent limit, focus on paying off credit cards with the lowest balances.

Use your credit cards sparingly. Even if you pay them off in full every month, carrying a large balance each month can hurt your credit score. Some credit card

issuers including American Express and Capital One do not report credit limits to CRAs. If they don't and you consistently charge approximately the same amount every month, the credit-scoring system assumes you are charging to your limit each billing period. To avoid this happening, be sure to pay the balance down well before the date when the billing period closes.

Correct errors in your credit report. It's always worth contacting CRAs if there is/are:

- any negative item listed that is not yours, including late payments, charge-offs and collections
- errors in current credit limits
- any account listed as anything other than "current" or "paid as agreed" if you did pay on time and in full
- any accounts still listed that were part of a past bankruptcy
- any negative item more than seven years old (bankruptcy, 10 years)

Don't be concerned with:

- misspellings of your name
- outdated or incorrect address information
- old employers listed as current
- accounts you closed which are still listed as open

Be careful when closing unused credit accounts. Be sure your credit record shows that you know how to use a variety of types of credit over time. If you do decide to close some of your accounts, close accounts with lower limits first. Close newer accounts before older accounts. Keep those older accounts so your record will show the length of time creditors are looking for when deciding whether to give you credit or not.

Use old accounts at least every few months to keep them current. Older accounts are more valued than newer accounts by the credit-scoring system.

Conclusion

Credit scores are based on information in your credit file and determine what rate of interest you pay for loans. Use the suggestions in this publication to help you maximize your credit score.