

Facts About Credit Scoring

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Introduction:

The following information relates to the understanding and use of a credit score. Listed are details regarding the determination of a credit score, how you can find out what your credit score is, and what you can do if you have questions about your credit score. Such information is critical when borrowing finances for personal or business use. The point of this information sheet is to make you aware of issues related to credit and how managing your credit prudently can insure a good credit score. As of this writing, all information listed here is current.

Credit Reports:

If you have had a loan or credit account with a lender, the lender has probably reported activity on your account to a credit bureau. The three major credit bureaus in the United States are: Equifax, Experian, and TransUnion.

Since lenders may not transfer account activity to all credit bureaus, your credit report may vary among credit bureaus. Therefore, it is important to check your credit report annually with each of the three credit bureaus.

The federal Fair and Accurate Credit Transactions Act of 2003 (FACT Act) allows that every U. S. resident may annually order 1 copy of their credit report free-of-charge from each of the 3 major credit bureaus.

Contact information is as follows:

- **Equifax:** <http://www.equifax.com>
800-685-1111
- **Experian:** <http://www.experian.com/consumer/index.html>
1-888-397-3742
- **TransUnion:** <http://www.transunion.com/>
800-888-4213

Credit Scores:

Credit scoring, sometimes called risk scoring, is a rating by a credit bureau to determine your credit worthiness and the likelihood and timeliness of loan repayment. A credit score may impact whether or not you receive credit as well as other credit terms such as percent interest rate, etc. Lenders consider several factors, including a credit score, when extending credit.

Equifax, Experian and TransUnion determine a credit score based upon a formula developed by the Fair Isaac Corporation. Each credit bureau uses a different term for their credit score. Equifax calls their score "Beacon;" Experian calls their score "FICO;" and Trans Union calls their score "Empirica."

Again, since lenders do not usually report account activity to all credit bureaus, a credit score may vary among the three credit bureaus. Credit scores may range from 400 to 900 with the average around 700. According to the scoring model, as your score increases, your risk of default decreases.

Five Factors Used in Determining a Credit Score:

There are five basic factors that constitute a credit score. Those factors are outlined here:

Payment History:

Approximately 35% of a credit score may be based upon payment history. A credit score is negatively impacted if bills are paid late or if there is a history of delinquent payments listed on the credit report, including matters of public record

such as bankruptcy, collection accounts, etc.

Amounts Owed :

Approximately 30% of a credit score may be based upon amounts owed or other outstanding debt. A credit score can be negatively impacted if the amount owed is close to the credit limit. A low balance on two credit cards may be better than a high balance on one credit card.

Length of Credit History:

Approximately 15% of a credit score may be based upon length of credit history. A credit score can be positively impacted the longer that accounts have been open, especially if they are with one financial institution.

Taking on More Debt:

Approximately 10% of a credit score may be based upon how much new debt a consumer is incurring. A credit score may be negatively impacted if someone has recently applied for a number of new credit accounts.

Promotional inquiries usually do not negatively impact a credit score.

Types of Credit in Use:

Approximately 10% of a credit score may be based upon the types of credit currently in use by a consumer. A credit score is usually negatively impacted by loans from finance companies.

When a lender receives a credit score from the credit bureau, there will be reasons included that explain the score. If the lender rejects a request for credit, and the credit score was part of the reason, the reasons help the lender explain why the score was not higher. Credit score reasons are also useful in determining whether or not a credit report contains errors and/or how a consumer's credit health might be improved.

Additional Information:

Q. What if I'm turned down for credit?

A. If you have been turned down for credit, the Equal Credit Opportunity Act (ECOA) gives you the right to obtain the reasons why within 30 days. You are also entitled to a free copy of your credit report within 60 days. You can request the report from the three credit bureaus listed on page one.

Q. What is a good credit score?

A. Since there is no one "score cutoff" used by all lenders, it is hard to say what a good score is outside the context of a particular lending decision. Your lender may be able to give you guidance on the credit score criteria that they use for extending a given credit product. See "Credit Scores" section on page one.

Q. Why is a good credit score so important?

A. A good credit score creates opportunities for access to credit as well as helping you access credit more rapidly and with better terms. A good credit score also gives you access to a larger amount of credit, assuming you can prudently manage that credit and you have the capacity for repayment of the credit.

Q. Should I close old accounts to raise my score?

A. Generally, this does not work. This action may lower a credit score. Late payments on old accounts will not disappear from an old account by closing the account. Long established accounts show a longer history of managing credit which is good for a credit score. Having available credit does not necessarily lower a credit score either.

Q. What other criteria does a lender consider in addition to my credit score?

A. Lenders consider other than just your credit score when deciding whether or not to extend credit. They consider the amount of debt you can handle given your income, your employment history, your credit history, as well as staying within their institutional underwriting policies.

Q. What should I do if there is an error on my credit report?

A. If you find what you think is an error on your credit report, notify the credit reporting agency. They are required to investigate and respond to you within 30 days of your notification to them. If you find the error during the time you are applying for a loan, immediately notify your lender of the error.

Q. What are some of the things done that can create an error?

A. Some of the things that can potentially create an error on your credit report are: 1) applying for credit without making sure your name is correct and complete, especially if it is a common name such as James Jones vs Jim Jones, 2) a clerical error made when entering data which should be corrected by notifying the credit reporting agency, 3) giving an incorrect Social Security number and 4) loan and credit card payments that have been applied to the wrong account.

Q. If I have a good credit score, what can I do to keep it that way?

A. There are several things you can do and they include:

1. pay all your bills on time,
2. if you have missed a bill payment, get the payment current and then keep it current,
3. if you are having trouble paying all your bills, contact your creditor or see a legitimate credit counselor,
4. know that paying off a collection agency account or closing an account that you were delinquent on will not remove the action from your credit report,
5. keep the balances owed on your credit cards and other lines of credit as low as possible,
6. pay off debt rather than move it around to other agencies,
7. do not open a number of new credit card accounts just to increase availability of credit,
8. do not close credit card accounts as a short-term solution to increasing your credit score,
9. if you have had credit for only a short period of time, do not open a lot of new accounts too rapidly,
10. prudently apply for and open new credit accounts when needed,
11. manage your credit card accounts prudently such as paying off the balance each month if possible, and
12. note that simply closing an account does not make it go away, especially if it has a bad credit history.

Q. Are credit scores fair?

A. The credit scoring process is fair. The process does not take into account your race, gender, color, religion, national origin, or marital status. It does not include your age, your occupation, your income, or where you live. The scoring process does not take into account interest rates being charged on credit cards you hold or any other credit you are responsible for. It does not include child or family support obligations or rental agreements. Inquiries about your credit score by employers or lenders without your knowledge or by yourself are not taken into account in the scoring process. Also not included is any information not found in your credit report or information that is not proven to be predictive of your future credit performance. Note however, that the lending institution may ask you about such things as your payment obligations, your employer and employment history, and your salary. Again, these items are not included in your credit score however.

Q. What does it mean when credit score inquiries are counted and may mean greater credit risk?

A. Credit bureaus count the number of credit inquiries related to your credit score. However, not all inquiries are included in that count. When you order a copy of your credit report it is not counted. When a lender makes an inquiry to review your account or to pre-approve you for a credit offer, the inquiry is not counted. Inquiries made by employers are also not counted.

However, if you are "rate shopping" for credit, each inquiry made can count on the score. A large number of inquiries mean greater risk. Six inquiries or more on a credit report can indicate an eight times greater chance of bankruptcy compared to people with no inquiries. The score process does compensate for this by counting multiple inquiries in any 14 day period as one inquiry. Also, the score ignores all inquiries made within the period 30 days prior to scoring—if you find a loan within 30 days, the inquiries from rate shopping should not affect your score.

Q. Why are my loans not listed on my credit report?

A. Many financial institutions do not report to all three major credit bureaus. If your financial business is with just one institution and that institution reports to only one credit bureau, your credit report will indicate your credit activity with that credit bureau only. This situation may make it difficult to obtain other credit such as a credit card, etc. Establishing needed credit with another institution and repaying that credit in a timely fashion can establish your credit record with other institutions (see "Credit Reports" and "Credit Scores" sections on page one).

Q. Where can I get more information on credit scores?

A. Visit the website www.myfico.com. On the website's lower right corner click "Credit Education Documents" and download *Your Credit Scores and Understanding your FICO Score*. If you do not have access to the Internet, contact your County Extension Office or local library.

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Data Source:

Understanding Your Credit Score, Fair Isaac
Corp.

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