

Credit Reports and Scores

Advanced Level

The Importance of a Credit History for Obtaining Credit

Credit refers to borrowing. You have used credit if you receive money, goods, or services in exchange for your promise to pay back a definite sum of money at a future date. For example, if you receive a loan to pay for higher education expenses, you are using credit.

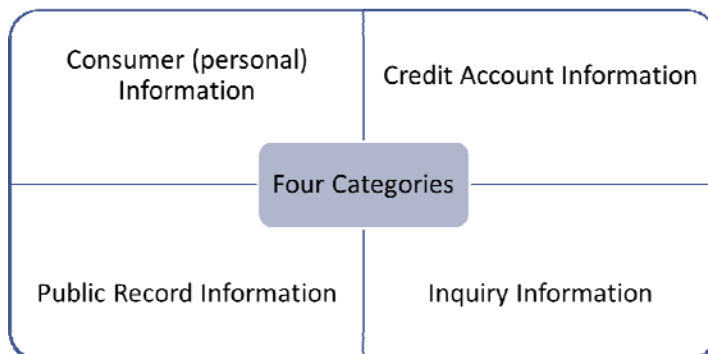
When a lender grants credit to a borrower, the lender “trusts” the borrower to repay what was borrowed. To help determine whether or not to grant the borrower credit (as well as determine the terms of credit offered), a lender will often examine the borrower’s credit history. A **credit history** is a record of the borrower’s past loans and credit-related transactions. Your credit history is presented in your **credit report**, the record of your use of credit.

Credit Reports and Credit Reporting Agencies

Credit reporting agencies (sometimes called credit bureaus) create credit reports based on the information they receive from lenders regarding your account history with that lender. **Credit reporting agencies do not decide whether or not to grant you credit; the agencies only collect credit history information.**

There are three credit reporting agencies in the United States: Equifax, Experian, and TransUnion. Therefore, you may have three credit reports (one from each credit reporting agency). Because lenders choose what information to report and to which credit reporting agency (ies) that information is shared, your credit report may vary across the three national credit-reporting agencies. If you have never used credit, or it has never been reported for you, then you will not have a credit report.

Credit report information is divided into four categories:



- 1.** Consumer (personal) information – This is information you have provided to lenders when applying for credit. It includes your name, current and previous addresses, telephone number, full or partial Social Security number, date of birth and current and previous employment information.
- 2.** Credit account information – The largest section of most credit reports contains specific information about each of your credit accounts.

Credit account information may include:

- ▶ *Type of credit* – there are two main types of credit on your credit report: closed-end credit and open-end credit.

Closed-end credit

(also known as installment credit) is a loan that you must repay in a specified number of equal monthly payments. Examples of closed-end credit include automobile loans, mortgages, and education loans.

Closed-end credit usually has an agreement (contract) that must be signed outlining the repayment terms such as the amount of the payment, the number of payments that will be made and the interest rate.

Open-end credit

(also known as revolving credit) is extended as a line of credit established in advance so you do not have to apply for credit each time new credit is desired. Credit cards are a type of open-end credit. A unique feature of open-end credit is that you can pay the loan balance in a single payment or a series of equal or unequal payments, usually monthly. You choose how much to pay each month. However, the lender typically requires a specified minimum monthly payment.

- ▶ *Loan amount or credit limit* – For closed-end loans your credit report will indicate the original loan amount. Open-end credit will indicate a **credit limit**, which is the maximum dollar amount that can be borrowed. If credit limit is not available, the report may indicate the highest balance ever on the account.
- ▶ *Date* – Information for each account will show the dates the account was opened, closed and last reported.
- ▶ *Account balance* – The account balance shows the remaining amount you owe the lender.
- ▶ *Payment information* – For each account, your credit report presents the size of your monthly payment, whether the payment is late (and by how much) and your payment history on the account including the number of late payments over time.

3. Public record information - This section of the credit report presents information from federal, state, and county public court records. This may include credit accounts that have been turned over to **collection agencies**, which are businesses hired by lenders to pursue payments on debts that borrowers have not paid back according to the terms of the credit contract. If you have filed for bankruptcy, if you have any **tax liens** (when taxes are not paid in full), and any history of **foreclosures** (when a borrower fails to keep up with mortgage payments and the lender takes possession of the property) this information will also appear in a credit report.

4. Inquiry information – An inquiry occurs when someone with permissible purpose requests a copy of your credit report. Credit reporting agencies record all inquiries received in the prior two years.

In order for a credit reporting agency to provide a person or business with your credit report it is law that the person/business must have a “permissible purpose.” Permissible purposes to receive your credit report include:

- Open or manage credit accounts
- Provide offers for credit
- Underwrite insurance
- A business transaction initiated by the consumer
- Court order or federal jury subpoena
- Valuation of risk of an investor
- Eligibility for government license
- Disclosure to consumer
- Employment purposes

The specific information included for each account on your credit report will depend upon the type of account.

Lenders such as depository institutions, credit card companies, retail stores that offer credit, and mortgage/finance companies usually report all information, positive and negative, to credit reporting agencies.

Data furnishers such as landlords, cell phone companies, utility companies (electricity, gas, water), and medical providers most likely only report when the consumer has not paid the money owed to them. For example, if you are late paying your cell phone bill, the cell phone company may report that information to credit-reporting agencies. Medical providers may report late medical payment but may not report non-financial medical information, such as what was treated or the treatment facility. Increasingly, credit-reporting agencies are encouraging and compiling regular payment information from non-creditors such as apartments and utilities as a way to help consumers build a positive credit history.

Race, religion, gender, and nationality may not be included on a credit report. In addition, credit reporting agencies do not record information regarding non-credit depository institution account information (such as checking and savings accounts), criminal backgrounds, or buying habits.

**Your Present Self
Impacts Your Future Self**

Time is the only way to remove potentially negative information from your credit report. Information remains on your credit report for a specific amount of time depending on the type of information.



Do you use credit? If so, what types?

Credit Scores

A **credit score** is a numerical summary of your credit history that indicates your creditworthiness, or likelihood of repaying a loan as agreed. Basically, a credit score is a numeric “grade” of a person’s creditworthiness. Credit scores enable lenders to make more objective and consistent lending decisions quickly and fairly.

There are different types of credit scores, each calculated differently. The most common credit scores available to consumers are produced by credit reporting agencies and companies such as Fair Isaac, Corp (FICO) and VantageScore.

FICO scores and VantageScores are calculated using only information from your credit report including (but not limited to) items such as:

- ▶ the number of credit accounts you have
- ▶ the type of credit accounts you have (closed-end versus open-end)
- ▶ whether you pay your bills on time
- ▶ how much of your available credit you are currently using – this is usually for open-end credit where the amount owed is compared to the credit limit
- ▶ whether a collection agency is trying to collect debt from you for a lender
- ▶ the total amount of money you currently owe to all lenders
- ▶ how long you have had current credit accounts
- ▶ whether you have a prior bankruptcy, foreclosure or other credit-related public record items in your credit report

**Positive
Credit
History**

**Higher
Credit
Score**

Because FICO scores and VantageScores are calculated only from the information in a credit report, any information not allowed in your credit report is not used to calculate your credit score. So, items such as race, religion, age, salary, occupation, employment history, where you live, interest rates on current credit accounts, and net worth are not used to calculate your credit score. However, although this information is not included in a credit score, each of these items (with the exceptions of race and religion) may still be considered when a lender reviews a credit application.

Each credit-scoring model has its own range of scores. Credit scores typically range between 300 and 990. Higher scores represent a greater chance of the consumer repaying a loan. Each credit scoring method has its own scale that helps a lender evaluate the probability that you will repay the loan. For example, the FICO credit score ranges between 300 and 850, and the VantageScore credit score ranges from 501-990. For both of these scoring models, your score will be displayed along with how you rank relative to other borrowers (such as excellent, good, average, or A, B, C, etc.). It is possible to have an “excellent” score from one scoring model and a “good” score from a different scoring model.

Why is it important to have a positive credit history?

A positive credit history informs lenders that you are financially responsible and therefore pose less risk. If you have a negative credit history or no credit history you may not be able to obtain credit.

Credit history also helps a lender determine the terms of credit granted. These terms may include the interest rate and loan length. Over a lifetime, you will pay more for credit (in higher interest rates and fees) if you have a lower credit score as illustrated in the example:

This is based on a 3-year, \$15,000 automobile loan			
FICO Score	Interest Rate	Monthly Payment Made	Total Amount Paid
730	6.16%	\$457	\$16,452
660	8.77%	\$475	\$17,100
590	14.43%	\$516	\$18,576

Note: As your credit score decreases, your interest rate increases.

Credit history can affect more than just credit. It also impacts:

▶ **Insurance -**

Insurance companies may use your credit report and/or score to decide whether you can get insurance and to set the rates you will pay.

▶ **Employment -**

Employers may use your credit report if you give them permission to do so, to decide whether to hire you.

▶ **Public Utility Services**

– Telephone, cable and utility companies may use your credit report and/or score to decide whether to provide services to you.

▶ **Housing -**

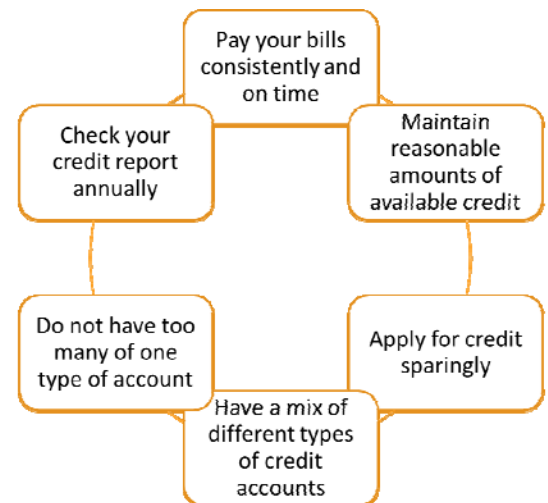
Landlords may use your credit report and/or score to determine whether to rent a place to live to you.

How do you develop a positive credit history?

Understanding what is included in your credit report and what information is used to calculate your credit score will help you to keep your credit history positive. Follow these tips:

- Pay your bills consistently and on time – Setting up automatic payments can ensure this gets completed.
- Maintain reasonable amounts of available credit – Keep low balances on credit cards and other revolving credit with credit limits.

- Apply for credit sparingly – When you apply for credit a lender will most likely request to view your credit report. This is recorded as an inquiry. Inquiries from a lender that are initiated by you when seeking additional credit may negatively affect your credit score. However, credit-scoring models recognize that a person may want to shop around to find the best credit terms. Therefore, multiple inquiries for the same type of loan, like a mortgage or automobile loan, are counted as a single inquiry if conducted within any 14-day period. This minimizes or eliminates any impact on a credit score. Inquiries that are not initiated by you (such as for pre-approved credit offers), inquiries not related to credit (such as pre-employment checks), and checking your own credit report do not affect your credit score.



- Have a mix of different types of credit accounts and not too many of one type of account - A mix of closed-end credit and open-end credit may improve your score. However, too many of either type of credit may also hurt your score.
- Check your credit report annually – Confirm that all information is correct.

Having no credit history may also result in the denial of credit. You will not develop credit history if you have no credit accounts in your name or pay cash for all purchases.

How do you begin to develop a credit history?

To begin building a positive credit history, experts recommend that you acquire and positively manage small lines of credit. The following are credit options for those who need to begin building positive credit history:

▶ Become an authorized user on a credit card: Have a parent or guardian add you as an “authorized user” on a credit card account. An authorized user isn’t legally responsible for the debt, but the history and use of the credit card is reported on the authorized user’s credit report. However, being an authorized user may not contribute to the establishment of positive credit history if the credit card has negative credit history associated with it. In addition, authorized user accounts typically have less positive impact on credit scores and depending on the scoring model may not be included in the score calculation at all because the authorized user is not responsible for the debt.

▶ Obtain a small closed-end loan from a depository institution: Acquire a small closed-end loan for an item that you already have money to pay for. Have that money available in a separate account, and set up automatic withdrawals to make the loan payments. This will ensure no late payments, showing that you use credit responsibly. If you are under the age of 18, you must have an adult co-signer to obtain a closed-end loan.

▶ Obtain a secured credit card: A secured credit card requires a cash security deposit to ensure payment of the credit card. Essentially, the deposited money ensures the credit card company that the credit card will be paid, regardless of whether you have a prior payment history.

▶ Obtain a cosigner: Apply for a credit card with a parent or guardian as a co-signer. A **co-signer** is a person who is equally responsible for paying back debt under the credit terms. Make sure co-signers understand that they are equally responsible for the debt, and it will appear on their credit report as well. Then, manage the credit card account very responsibly by paying the balance on or before the due date. In order to obtain a credit card if you are under the age of 21, you must have a co-signer or proof of sufficient income to make payments.

Think before you co-sign!
Regardless of who uses the account or pays the bills, all information, (good and bad) will appear on your credit report.

Obtaining Credit Reports and Scores

Credit Reports

By federal law, everyone must be able to obtain one free credit report from each of the three credit reporting agencies (Equifax, Experian, and TransUnion) every twelve months.

You may request your credit report in three ways:

1. Visit the website www.annualcreditreport.com
2. Call 877-322-8228
3. Write to: Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281. You will have to provide certain information to access your report, such as your name, current address (and possibly your previous address), Social Security number, date of birth and answer questions about your personal credit history.

Laws vary between states. Some states may allow additional free access to credit reports and scores.

There are many websites that advertise access to free credit reports. However, www.annualcreditreport.com is the only government-sponsored, free website. Most other websites charge some type of fee.

To continually monitor your credit report, it is recommended that you request a credit report from one of the three credit reporting agencies every four months. If you need more than one of each of your credit reports per year you can acquire them at a price set by law. It's important to request your credit report even if you have never used credit before to ensure that no one is fraudulently using your name to obtain credit.



If a company denies you credit because of information in your credit report, the company must supply you with the name and address of the credit-reporting agency that supplied the credit report. You can then request a free copy of your credit report to review within 60 days of being denied credit regardless of whether you have already received a free copy in the past 12 months.

The law that allows you a free copy of your credit report each year does not extend to credit scores. Credit scores have to be ordered separately and usually cost a fee. The three credit reporting agencies are the primary source for obtaining your credit scores, although FICO scores can be ordered directly from Fair Isaac, Corp. The content of your credit report across each of the three credit reporting agencies may vary, which means you could have three different FICO scores (and similarly for VantageScores).

What if I find errors in my credit report?

It is important to examine your credit reports and make sure all information is correct because there's always a possibility of finding errors. If you find errors, you have the right by federal law to dispute the information and request that the error be deleted or corrected.

To submit a dispute, you should contact both the credit reporting agency that provided the report and the company/person that provided the incorrect information to the credit-reporting agency. Your dispute must be investigated usually within thirty days. When the investigation is complete you will receive the written results of its investigation. If the dispute is found to be an error, either the credit reporting agency or the company/person that provided the incorrect information to the credit reporting agency must notify all three credit reporting agencies of the error so the agencies can correct the information in your credit reports.

If an investigation does not resolve your dispute and remove the information from your credit report, you can ask that a statement of the dispute be included in your future credit reports. The statement will be included in a "Consumer Statement" section of all future credit reports. You also can ask the credit bureau to provide your statement to anyone who received a copy of your report in the recent past, but you may have to pay a fee for this service.

If you are dissatisfied with the dispute resolution, you can file a complaint with the Consumer Financial Protection Bureau to receive individual assistance.

There are many debt repair agencies that advertise the ability to help a consumer 'fix' his/her negative credit report for a fee. The Better Business Bureau (BBB) and the Federal Trade Commission (FTC) agree: Consumers can do just as good a job improving their credit reports as a fee-based debt repair agency. There is no immediate fix for negative credit; it will take time and responsible credit management initiated by the consumer.