NATIONAL ENDOWMENT FOR
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**CREDIT SCORES: AN OFTEN-OVERLOOKED,
BUT ESSENTIAL, ELEMENT IN FINANCIAL PLANNING**
Learn Why They're Important and How You Can Improve Yours

ENGLEWOOD, COLORADO—Have you applied for a mortgage, car loan, credit card or job lately? Chances are that your credit score played a significant role in whether or not you received the money, credit or even the employment position you were seeking. It's also likely that your credit score affected the interest rate of your mortgage, loan or credit card.

Your individual credit score helps lenders decide whether or not to loan you money, and how much of an interest rate to charge. It also can help employers decide whether or not to hire you. Credit scores even can help landlords decide whether or not to enter into a lease agreement with you. Despite the significant role credit scores play in our lives, many Americans are unaware of their credit score or its implications. In fact, according to a 2005 survey by the Consumer Federation of America and the Fair Isaac Corporation, nearly half of all Americans do not understand that credit scores measure credit risk.

"Knowing your credit score, and understanding where the number came from, what it means and how to improve it, is an important aspect of personal finance," says William L. Anthes, Ph.D., president and CEO of the National Endowment for Financial Education® (NEFE®). NEFE is a nonprofit foundation dedicated to helping Americans achieve financial well-being. Anthes says, "Having a positive credit score can help you get the credit you need to buy a home or car, and it can save you thousands in interest rate charges. But if you don't know enough about your score, you are putting yourself at a severe disadvantage when it comes to applying for future credit."

Below, Anthes answers basic questions about the credit-scoring process.

What is a credit score?

Your credit *score* is a number that is derived from a mathematical equation using the information in your credit *report*. The number tells lenders how likely it is that you will pay back a loan in a timely manner. According to Anthes, "Not every credit score is the same. For example, different lenders may have unique formulas for obtaining your credit score. However, usually when people refer to your credit score, they are referring to a number derived from software created by the Fair Isaac Corporation."

All three of the major credit-reporting agencies (Equifax, Experian and TransUnion) use this software to obtain credit scores. This system produces scores that range from 300 to 850. The higher your score, the lower a credit risk you pose to lenders, and, subsequently, the more likely you are to get a better interest rate on loans, credit cards and mortgages. Conversely, the lower your score, the higher the risk you pose to a potential lender or employer.

What makes up a credit score?

Anthes says, "Your credit score is a numeric representation of your credit report. It's an easy and efficient way for lenders to decide whether or not to loan you money without having to analyze your entire credit report themselves. It also makes the lending process more equitable." Your credit report basically is a summary of your current credit situation and history. Each of the following sections of your credit report is factored into your score, but in varying percentages.

- Payment history—Whether you pay your bills on time, or at all, is the most influential factor in the calculation of your credit score. It makes up 35 percent.

- Accounts owed—This item makes up 30 percent of your score. How favorably it impacts your score depends upon how many accounts you have, how much credit you have available on each account and how much you owe on each account.

- Length of credit history—The length of time you've accumulated credit plays a role in your score, as well. Fifteen percent of your score is made up of items such as how long your accounts have been open.

- New credit—Ten percent of your score is determined by recently opened accounts and credit inquiries.

- Types of credit used—The final 10 percent of your score is determined by the variety of credit you have, such as mortgages, credit cards or installment loans.

Your credit score does not include any information about you that is not part of your credit report. It does not include information about your age, race, gender, religion, national origin or marital status. Your credit score also is not affected by your address or information about your employment, such as your occupation or salary. It does not include interest rates being charged to you, child support payments or rental agreements. Although your credit score takes into account recent requests made to view your credit report, it does not consider requests *you* have made for your credit report or inquiries made by lenders in order to make promotional credit offers. Employer requests are not included either. Finally, your credit score does not consider whether or not you are working with a credit counseling service, which is an organization that can help consolidate your debts if you find that you are struggling to pay them off in full.

How do I obtain my credit score?

Up until just a few years ago, credit scores were not accessible to consumers. Lenders were prohibited from telling their clients their scores, and there was no way to obtain your score on your own. However, in 2000, consumers found out about the existence of credit scores and demanded the right to view them. They not only wanted to know their scores, but also how to improve them if they were negative, or change them if they were based on incorrect information.

Consumers now have access to both their credit score and their credit report through the three credit-reporting agencies. In addition, recent legislation entitles consumers to one free credit report each year. (This service currently is available to Americans in the Western, Midwestern and Southern states. Consumers living on the East Coast will be able to obtain theirs by September.) However, all Americans still have to purchase their credit scores.

Anthes says, “All consumers should request their credit report and score from the three major credit-reporting agencies at least once a year. You also should always review your score and report six months prior to a major purchase for which you are using credit, such as a car or home. This way, if you notice an error, you’ll have time to correct it.”

You should request your report and score from all three credit-reporting agencies because they occasionally have different information. You can order your credit report and score from these agencies by telephone or online. Their telephone numbers and Web sites are:

Equifax
1-800-685-1111; www.equifax.com

Experian
1-888-397-3742; www.experian.com

TransUnion
1-800-916-8800; www.transunion.com

If you live in a state where you are eligible to receive a free report, you may request it from www.annualcreditreport.com or by calling 1-877-322-8228. From here, you can access reports from the three credit-reporting agencies for free once a year. When you order your reports, you also will have the opportunity to purchase your score.

What if something on my credit report is incorrect?

Once you receive and review your credit report, you might find something that is incorrect or incomplete. “This information may be adversely affecting your credit score, so you should attempt to fix the error as soon as possible," Anthes says. Begin by telling the credit-reporting agency in writing about the inaccuracies in your report. With your correspondence, include copies of documents that support your position. You also should send the same information to the lender who provided the incorrect information.

The credit-reporting agency usually will investigate your claim within 30 days. They will forward your claim to the lender who provided the information in question. The lender then will investigate the claim and report back to the agency. If the information is found to be incorrect, the credit-reporting agency will fix your credit report and provide the correct information to the other credit-reporting agencies. Any information you dispute that cannot be verified must be removed.

If your claim results in a change in your credit report, the credit-reporting agency will send you notification and a corrected report for free. If you wish, they also will send notification of the change to anyone who requested your report within the last six months. If the credit-reporting agency's investigation into your claim does not result in removing the information, and you still feel it is inaccurate or incomplete, you may write a short personal statement explaining the issue. Ask that the agency include this statement in future credit reports. All lenders viewing your report will see the information in question, but they also will see your statement.

How do I improve my credit report?

Unfortunately, in some cases, negative information on your credit report may be accurate. In this case, it will not be removed until the appropriate amount of time has passed. For most information, this is seven years. Personal bankruptcies, however, can stay on your report for up to 10 years.

Although it may take time, there are financial steps you can take to improve your credit score. Anthes offers the following suggestions:

- Payment history—The best way to improve your payment history is to pay your bills on time. Late payments have a significantly negative impact on your credit score. Having an account sent to a collection agency further damages your score, and filing for bankruptcy has an extremely negative impact.

- Accounts owed—Keep your credit card balances as low as possible. "This strategy will not only raise your score," Anthes says, "but also save you from paying high interest rate charges on your purchases." Also, don't close numerous accounts as a short-term credit score fix. This potentially could lower your score.

- Length of credit history—Anthes says, "Just as you shouldn't close many accounts in a short period of time, you shouldn't open numerous accounts quickly either. It can bring down the average age of your accounts and actually lower your score." Instead, if you don't have much history, consider applying for one credit card and using it occasionally. Be sure to pay it off each month. If you don't have enough credit history to obtain a regular credit card, you may be able to get a secured credit card, which is backed by money in your bank account.

- New credit—Anthes says, "While numerous credit inquiries in a short period of time can negatively affect your score, don't let this stop you from seeking the best interest rate possible on a potential loan. Shopping around doesn't adversely affect your credit score." For example, if you check interest rates with three different lenders for a car loan within a short period of time, your credit score only will reflect one inquiry, as they are all for the same potential credit line.

- Types of credit use—Don't open accounts just so that you will have a better mix of credit. Instead, manage the accounts you have responsibly.

Anthes says, "The keys to getting and keeping a strong credit score really are relatively simple. Always pay your bills on time. Manage your debt responsibly. Don't abuse credit. If you follow these guidelines, you'll improve your credit score, and you'll be on your way toward achieving financial well-being."