Family Economics & Financial Education

Understanding Credit Reports

What is Credit?

Credit is when goods, services, and/or money are received in exchange for a promise to pay back a definite sum of money at a future date. For example, receiving a loan to pay for higher education expenses is credit. The lender "trusts" the borrower to repay the money. A **lender** is the person or organization who has the resources to provide the individual with a loan; for example, credit card companies and depository institutions where loans are acquired. When the privilege of borrowing has been extended, the **borrower** is usually expected to pay interest in addition to the amount borrowed. **Interest** is the price of money. When referring to credit, interest is the charge for borrowing money.

Credit Reports:

A **credit report** is a record of a consumer's credit history. **Credit history** is a record of transactions involving the use of credit. It shows the extent to which bills are paid on time, requests for additional credit, how much debt an individual has and much more. If an individual has not used credit, they will not have a report. A **credit reporting agency** keeps records of a consumer's credit transactions and compiles credit reports. There are three main credit reporting agencies in the U.S.: Equifax, Experian, and

Lenders who report consumer's credit transactions may include:

- Retail stores that offer credit
- Credit card companies
- Mortgage and finance companies
- Landlords
- Financial institutions
- Cell phone companies
- Utility accounts (telephone, power, gas, and water);

Information In a Credit Report

Business that report information to credit reporting agencies do not always report to all three agencies. Therefore, an individual's credit history may vary in each report. Information in a credit report can be divided into four categories and includes:

- Personal Information
- Name and aliases, current and past addresses, Social Security Number, date of birth, and employment history.
- Accounts summary
- Types of accounts, date the account was opened, credit limit or loan amount, account balance, and payment history, including missed or late payments.
- This includes most types of credit accounts such as automobile loans, credit cards, mortgages, etc.
- Public Record Items Related to Credit
- Accounts turned over to collection agencies, and public record information such as bankruptcy, tax liens, legal suits, and foreclosures.
- Credit inquiries – a request for an individual's credit report. Inquiries are completed by a variety of businesses that have a purpose to view a consumer's credit report, such as insurance agencies, current and potential credit companies, financial institutions, landlords, potential employers (with permission from the potential employee). Different types of credit inquiries impact an individual's score in different ways.

Soft credit checks are inquiries such as those that result when consumers check their own credit report, credit card companies pre approve consumers for a line of credit, or pre employment checks. These do not affect an individual's score.

Hard credit checks occur when the consumer gives permission to a company to check their credit usually when seeking additional credit. For example if an individual applies for a new credit card, automobile loan, insurance, or opens a new cell phone account, these usually affect the credit score.

Medical information, such as the facility where an individual was treated or what was treated, is **not** allowed on a consumer's credit report, but late medical payments are.[6] Race, religion, gender, marital status and nationality are not used to make credit decisions but gender and age may be found on a credit report.[5]

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Credit Scores

A **credit score** is a mathematical tool created to help a lender evaluate the risk associated with lending a customer money. The credit score is based upon the information in a credit report at a particular point in time. It is a numeric "grade" of a consumer's financial reliability and is used by lenders to determine a consumer's risk of defaulting on a loan. The most common scoring system is called the FICO score where credit scores range from 300-850, with 850 being the best (lowest risk) score.

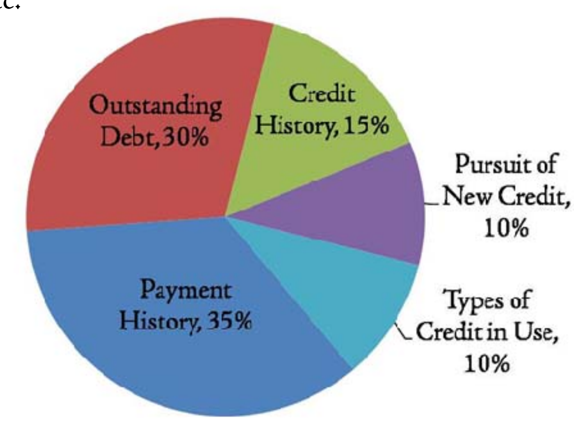
Over a lifetime, a consumer will pay more for credit (in higher interest rates and fees) if they have a lower FICO score. The table below illustrates that if you have a lower FICO score you will have a higher interest rate which leads to a higher monthly payment. Source: The Fair Isaac Company: www.myfico.com.

This is based upon a 30 year fixed mortgage rate for a $300,000 loan			
FICO Score	Interest Rate	Monthly Payment	30 Year Amount
760	5.9%	$1,787	$643,320
650	7.2%	$2,047	$736,920
590	9.3%	$2,500	$900,000

How Are Credit Scores Calculated

FICO credit scores are determined entirely by the information in a consumer's credit report. A statistical model examines all of the pieces of information in the credit report to predict the likelihood that the consumer will default on a loan. The website myfico.com reports the following five categories of factors used, and the percentage influence that each category exerts on the final FICO score:

- 35% - **Payment history** the timely manner in which a consumer did or did not pay the debt. This includes all types of credit accounts, late or missed payments, and public records and collection items.
- 30% - **Outstanding debt** is the total dollar amount of debt currently held. This includes balances on all reported accounts. For credit cards, the total amount owed across all accounts in relationship to the total amount of credit lines is an important factor. When a high percentage of a consumer's credit line is already in use this can indicate overextension and a greater likelihood of missed payments in the future.
- 15% - **Length of Credit history** is the amount of time the consumer has held credit accounts and how often they are used. This includes how long ago your credit accounts were established. A longer credit history will generally increase your credit score.
- 10% - **Pursuit of new credit** assesses how many accounts have been opened recently, and the type of account. This includes the number of recently opened accounts as well as requests for new credit. Opening many new accounts in a short period of time may be detrimental to a credit score, especially if the consumer is new to using credit.
- 10% - **Types of credit in use** analyzes the types of credit a person has in use comparing installment loans, credit cards, retail accounts, mortgage loans, etc.



Information not calculated in a FICO credit score includes:

- Race, color, religion, national origin, sex and marital status;
- Age;
- Salary, occupation, title, employer, employment history;
- Where you live;
- Interest rates charges on accounts;
- Overall wealth (assets an individual may have).

A person's credit score is not the only variable that may be considered by a lender when applying for a loan. Although not in included in a consumer's credit score, some of the variables noted above may still be considered when a lender reviews a loan application.

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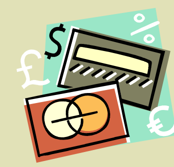
Positive and Negative Credit History

It is important that the information in a credit report reflects responsible credit use. A positive history informs lenders that the consumer is financially responsible and therefore poses less risk. If a consumer is irresponsible with his/her credit, he/she can develop a negative credit history. A negative history may prevent an individual from receiving a job, renting an apartment, or cause them to have to pay higher interest rate for credit they are able to obtain. Positive and negative credit practices include:

Positive	Negative
♦ Practice good banking techniques such as keeping a checkbook balanced, managing accounts online, and not bouncing any checks ♦ Pay bills consistently and on time ♦ Maintain reasonable amounts of unused credit ♦ Apply for credit sparingly, thus keeping credit inquiries to a minimum ♦ Check credit reports annually and search for errors	♦ Having non-sufficient funds (NSF) when writing checks, also known as bouncing checks ♦ Routinely paying late on credit cards, utility and cell phone bills ♦ Maxing out limits on credit cards ♦ Numerous credit applications in a short period of time

Building a Credit History

Although the following are all positive financial practices, a credit history is not established if a consumer performs the following actions:
- Not having any credit accounts in own name;
- Paying cash for all major purchases
- Paying phone and utility bills on time (they are only reported if an individual does not pay their bills responsibly).



The 2009 Card Accountability Responsibility and Disclosure (CARD) Act changed how young adults can receive certain types of credit. Under the CARD act, consumers must generally be 21 years of age or older to receive a credit card. Consumers under 21 can still get a credit card, but they need to either have a co-signer or show documentation of sufficient income to make payments. If an individual is under age 21 and has a card with a cosigner, the cosigner must agree in writing to any credit limit increases.

To start building a positive credit history, individuals should acquire and positively manage small lines of credit. The following are credit options for individuals who need to begin building positive credit history:
1. **Cosigner**: For young adults (18 years and older), obtain a credit card with a parent or guardian as co-signer.
2. **Small loan from a depository institution**: Acquire a small loan for an item for which the individual already has money available in a separate account. Then, set up automatic withdrawal to make the payments. Using a local bank or credit union where the individual already has a checking or savings account usually works best.
3. **Obtain a secured credit card** : Secured cards typically require a cash security deposit to ensure payment of the credit card. The larger the security deposit, the higher the credit limit granted. Often a bank does not pay interest on the deposited balance, but will allow the cardholder to "graduate" to a regular (unsecured) credit

If parents or guardians agree to be **co-signers** on an account, they are equally responsible for the loan. Therefore, the loan also is on their credit report as well positively or negatively impacting it depending upon how the credit is managed.

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Requesting Credit Reports

A consumer can request his/her credit report any time. The Fair and Accurate Credit Transactions Act entitles consumers to one free credit report each year from each of the three main credit bureaus. Consumers can access their credit reports in three different ways:

- By accessing the Web site www.annualcreditreport.com
- By calling toll free at 877-322-8228
- By sending written requests to Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281[1]

The website above is the only website supported by the Federal Government for free annual credit reports. There are other sites that use "free report" in their names or misspell annualcreditreport.com as their URL in the hopes that a consumer will arrive at their website instead. To acquire a credit report, individuals must provide personal information including their name, address, social security number, date of birth, and answer questions about their personal credit history. Individuals needing more than their three free copies annually can acquire them at a price set by law, not to exceed $10.50.[2]

It is recommended that consumers check each of their three credit reports once a year to make sure the information is accurate. A consumer can stagger their requests from each credit reporting agency every 4 months to constantly monitor the information.

ANNUALCREDITREPORT.COM

Click here to receive a free credit report.

When ordering your credit report you do not receive your credit score. This may be requested for a small fee.

Credit Scoring Companies

(if you click on a company icon, you are directed to their Web site and may have to pay for your credit report.)

Mistakes in Credit Reports

Consumer Reports cited a study in the June 2007 issue stating that consumers find more than 13 million errors on their credit reports.[3] Two main errors appearing in credit reports were fraud and mistaken identity. Mistaken identity occurs when a lender reports a credit transaction and information is recorded on the wrong person's credit report, usually of a similar name. In 1971, the Fair Credit Reporting Act (FCRA) was enacted to protect the consumer. It states consumers have the right to know what information is in their credit report and to correct any errors.[2] This legislation was designed to promote accuracy and ensure privacy of consumer information in consumer credit reports.

Under the FCRA, if a company denies an individual's application for credit, they must supply the name and address of the credit bureau that the information came from. The consumer can also request a free copy of their credit report to review within 60 days of being denied credit.[5] If an error is found on a credit report, it is important to immediately contact the credit bureau by phone and in writing.

Many debt repair agencies are available to help a consumer 'fix' his/her negative credit report. However, the Better Business Bureau (BBB) and the Federal Trade Commission (FTC) agree consumers can do just as good of a job repairing their credit reports as a fee based debt repair agency. There is no immediate fix for negative credit and debt repair agencies may just suggest bankruptcy.[2]

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